

JOURNEY TO THE FCA

October
2012



To make **financial markets** work well so **consumers** get a **fair deal**



Contents

Foreword by	John Griffith-Jones	4
Introduction by	Martin Wheatley: Our vision for the Financial Conduct Authority (FCA)	6
Chapter 1:	The creation of the FCA: Spotlight on some of our new powers	11
Chapter 2:	Protecting the perimeter	19
Chapter 3:	Ensuring firms continue to meet our standards	25
Chapter 4:	Taking action against firms that do not meet our standards	37
Chapter 5:	Building our understanding of the markets	41
Chapter 6:	Maintaining effective relationships	49
Chapter 7:	Accountability, transparency and measuring our success	55

**Annex A:
Specific questions for consultation**



FOREWORD

BY JOHN GRIFFITH-JONES
FCA CHAIRMAN-DESIGNATE

*This document sets out
how we will approach our
regulatory objectives; how we
intend to ensure firms put
consumers at the heart of
their business*

This is a unique opportunity to shape financial services regulation and deliver on the significant tasks the Government has set for us. I, together with Martin Wheatley and the new Board, will be on an exciting and challenging journey to create the Financial Conduct Authority (FCA). I am very proud that I am to be its first chairman.

Having worked in the professional services environment for more than 35 years, I fully appreciate how important conduct is to the integrity of markets and to protecting consumers. There is no substitute for high standards of behaviour, and that is our focus.

Regulation has to strike the right balance between allowing the industry to thrive and ensuring it retains its integrity and delivers what consumers expect from it. We will set ourselves demanding targets for our own performance, as well as expecting high standards from others in this regard.

This document sets out how we will approach our regulatory objectives; how we intend to ensure firms put consumers at the heart of their business; and where we are on this journey.

Regulation has to strike the right balance between allowing the industry to thrive and ensuring it retains its integrity and delivers what consumers expect from it.

We open the door to our new organisation to show you what it will feel like for you when it begins life next year. We encourage you to take a look inside and to give us feedback.

Day One of the FCA is only the start; our long-term vision and approach are fundamental to helping us meet our objectives. I hope this document demonstrates that we are on the right track, and I look forward to hearing your views.



INTRODUCTION

BY MARTIN WHEATLEY

FCA CHIEF EXECUTIVE-DESIGNATE

***Our vision for the
Financial Conduct
Authority***

*To make financial markets
work well so consumers get
a fair deal*

All problems have root causes. It is not always easy to trace the source of these problems and tackle them at their core, but this is what the Financial Conduct Authority (FCA) intends to do.

The FCA has three purposes. It is responsible for ensuring that markets operate with integrity; promoting effective competition; and requiring firms to put the well-being of their customers at the heart of how they run their business.

High standards of conduct in wholesale markets have always been important. Choices made and actions taken in markets can reverberate throughout the system and affect all of us. In today's complex, interwoven, international and domestic financial marketplace, high standards become ever more important. In recent years we have seen markets that have grown in complexity and now provide a proliferation of choice for all types of customers, both retail and wholesale.

The creation of the FCA is our opportunity to reset conduct standards for the financial services industry.

As a retail customer you expect some things to be simple and straightforward. Most of us want bank accounts where we can keep our money safe; mortgages that enable us to buy our own homes; and to be able to set aside savings for holidays, our retirement, or other significant life events.

And when we take out that bank account, we expect there to be no hidden charges. We expect a mortgage that is affordable and financial products that are suitable for our personal circumstances.

Meeting fair and reasonable expectations like these should be at the centre of how firms operate – firms should see it as their responsibility in the first instance, not the

So from the boardroom to point of sale and beyond, firms' behaviour, attitudes and motivations must be about good conduct...

responsibility of the regulator. This should be demonstrated through the way they treat their customers, their behaviour towards each other, and the way they operate in the market. This is what we mean by 'conduct' when we talk about the new FCA.

Things need to change; industry and the regulator need to rise to the challenge of that change. The creation of the FCA is our opportunity to reset conduct standards for the financial services industry. We are not starting from square one; we have made significant progress since the Government announced it would change the regulatory structure to make it operate more efficiently. Based on the proposed role and objectives for the FCA, we are creating an organisation whose vision is:

To make relevant¹ markets work well so consumers get a fair deal.

There are three broad outcomes we want to achieve. These are that:

- consumers get financial services and products that meet their needs, from firms they can trust;
- markets and financial systems are sound, stable and resilient, with transparent pricing information; and
- firms compete effectively, with the interests of their customers and the integrity of the market at the heart of how they run their business.

¹ 'Relevant' markets are: the financial markets; the markets for regulated financial services; and the markets for some other services that are provided by persons without requiring authorisation.

So from the boardroom to point of sale and beyond, firms' behaviour, attitudes and motivations must be about good conduct – especially in terms of the experiences and outcomes they offer their customers and clients, whether it is someone buying a basic product or completing a complex transaction.

We will allow firms to try new ideas and develop their business. In the UK there are more than two million people employed in financial and related professional services.² We have more bank branches per person than France, Germany or Italy. Our insurance industry is the largest in Europe and the third largest in the world. The FCA will regulate with this in mind, along with all the other indicators of how important the industry is, and will be careful not to stifle growth.

The Financial Services Bill 2012 (the Bill), currently going through Parliament, provides new powers to help us achieve our outcomes. These include the ability to ban financial products, publish details of misleading financial promotions, and let people know when we are proposing to take disciplinary action against a firm. Of course, the Bill may be subject to further change. This document is a statement of intent for the future, detailing how the FCA will carry out the functions that will be entrusted to it by Parliament and society.

The FCA will specifically consider and address potential conduct issues in new firms entering the market, and existing firms we regulate. When we consider authorising a firm, we will look at its business model to ensure it meets the needs of consumers and does not place them, or the financial system as a whole, at undue risk. We will balance these high standards with allowing innovation and appropriate access to the market by new firms.

Through our new style of supervision we will increase our focus on the conduct at the very top of firms. Firms' senior management teams set the culture of their organisations so we must ensure that the targets and aspirations set at the top turn into good outcomes for consumers. The six retail consumer outcomes that were set out in the Treating Customers Fairly (TCF) initiative³ remain core to how we expect firms to treat their customers. These outcomes will be part of the normal focus of the FCA, part of our approach and our language. We will continue to use them as an important factor in guiding our regulatory decisions and actions.

...we will step in earlier, and act faster, when we identify problems that risk harming consumers or the integrity of the market.

We will engage fully and openly with stakeholders, existing and new, to inform our understanding of risks in financial markets and to further inform our views of emerging consumer concerns. Making use of the information we gather, from a wide variety of sources, we will identify risks sooner and tolerate lower levels of risk.

This means we will step in earlier, and act faster, when we identify problems that could harm consumers or the integrity of the market.

Whilst it is reasonable for consumers to take responsibility for the decisions they make, a balance must be struck. Consumers cannot always be expected to have enough financial knowledge, information and understanding of complex products and risks to make informed decisions.

The Financial Services Bill 2012, currently going through Parliament, provides new powers to help us achieve our outcomes. These include the ability to ban financial products, publish details of misleading financial promotions, and let people know when we are taking disciplinary action against a firm.

² Source: TheCityUK, *Key facts about UK financial and professional services*, April 2012
³ www.fsa.gov.uk/doing/regulated/tcf

So all parties – consumers and firms alike – must take responsibility for their part in transactions. We recognise the real benefits that greater transparency – both from firms in the way that they deal with their customers, and from the FCA itself – can bring. We will publish a Discussion Paper in the first quarter of 2013, which brings forward proposals to embed regulatory transparency in ways that we believe will lead to real benefits for consumers.

Rules and standards affecting the UK's financial system are increasingly being made by the European Union (EU) and international bodies. To deliver our objectives, we will continue to look beyond the domestic agenda. The FCA will play an active role in shaping policies and driving the consumer protection agenda in Europe and internationally, both in the development of broad standards and in the detailed rules that affect UK consumers and firms.

In this document we set out how we may use some of our new powers in practice. We also set out our new approach and how it will differ from the way we currently operate. Lastly, the document reflects upon the organisational and cultural changes that are already underway. We will encourage our staff to be more confident in making bold, firm and predictable decisions. We will work collaboratively, including with our stakeholders, to inform our knowledge and understanding. FCA staff will ask more probing questions; in doing so we will develop a better understanding of firms' motivations.

The vision and ambition we have set out for the FCA are clear. Some areas will be new to us and will not be fully developed from Day One; for example, competition, where we use this document to set out our initial thinking and ask you for your views.

Things need to change: fresh thinking, new strategies and, above all, a focus on the consumer, which will lead the way to delivering a financial services industry that meets the needs and expectations of the people it was established to serve.

You may already be aware of some of the information in this document; we held workshops with around 500 firms and other key stakeholders to tell them about the FCA during the summer, and we have given a number of speeches and presentations throughout this year to set out our approach. This document brings together all our latest thinking and work on the FCA and we hope it provides our stakeholders with a better understanding of what all this change means for the day-to-day business of regulation.

Your views

The rest of this document provides a more detailed explanation of how we intend to achieve the FCA's vision. We continue to develop our approach and there will be further work to do in the coming months and beyond Day One of the FCA. We are interested in your views and your comments; and we are committed to considering them in our ongoing design work.

To make sure we get the approach right, we have questions on specific issues that we would like your views on – our approach to competition and gathering and receiving information.

There are a number of ways to submit your comments. If you are reading a PDF version of this document online, you are able to comment on each page – see details on the right-hand side. Otherwise you can send an email with comments to: FCAApproach@fsa.gov.uk, or by mail to:

FCA Approach, Financial Services Authority
25 The North Colonnade, London E14 5HS

We would be grateful for any comments and views by 14 December 2012. We will summarise and communicate the feedback we receive in early 2013.

We have advertised more *engagement events* around the country, where you can talk to our staff about our approach in much more detail.



CHAPTER 1:

THE CREATION OF THE FCA:
SPOTLIGHT ON SOME OF OUR
NEW POWERS

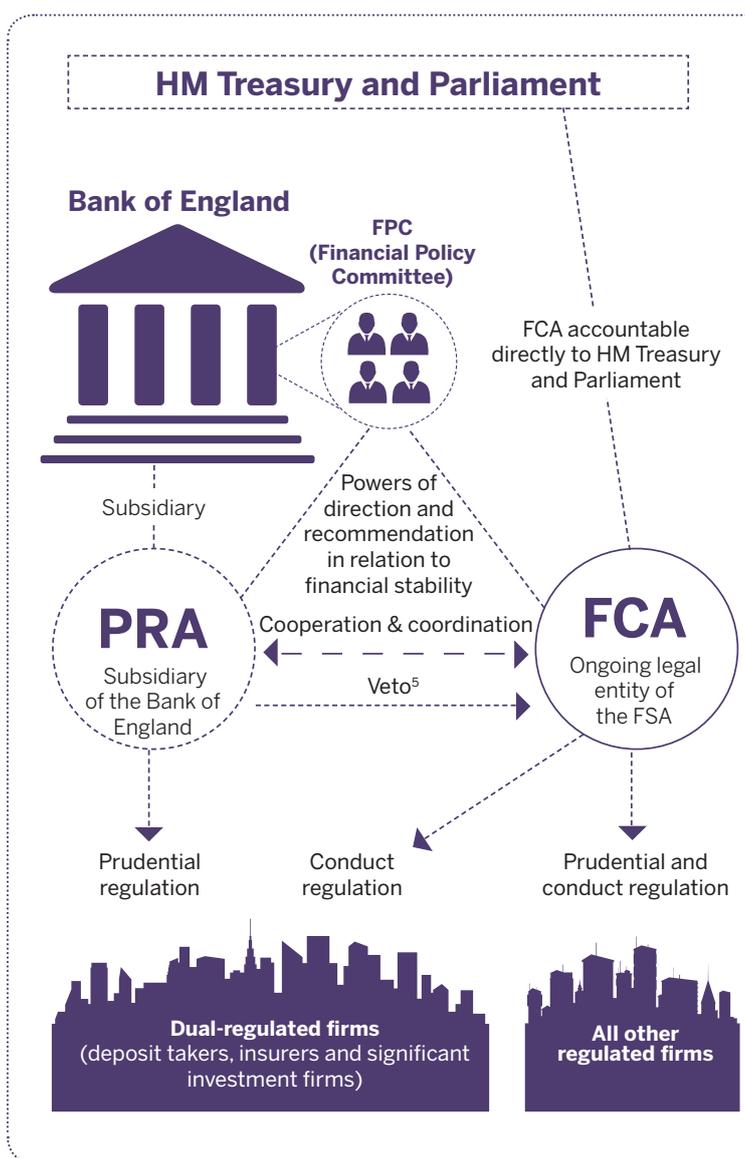
In the Financial Services Bill, currently under scrutiny in the House of Lords, the Government has set out the focus for the Financial Conduct Authority. It outlines that the FCA should as a statutory objective ensure that relevant markets work well. This will, subject to Royal Assent, be the FCA's focus.

Underpinning this objective the Government has outlined three key operational objectives. These objectives focus on the integrity of the market, consumer protection and competition. In time we will ensure that in every piece of work we undertake we consider the impact on consumers, on competition and on the wider integrity of markets.

This will mean that on every decision we take moving forward the FCA will examine the impact on competition, on consumers and on integrity. The FCA will consider how best to do this, especially as both competition and consumer outcomes can be at odds with one another. We will take considered decisions on the best way forward.

The new system for regulating financial services in the UK, as proposed by the Government, will involve a number of bodies, each with their own responsibilities and objectives:

- The FCA will be responsible for ensuring that relevant markets function well, for the conduct supervision of financial services firms, as well as the prudential supervision of firms not supervised by the Prudential Regulation Authority (PRA).
- The PRA will be responsible for promoting the safety and soundness of deposit-taking firms, insurers and systemically important investment firms.⁴
- The Bank of England will be responsible for protecting and enhancing the UK financial stability. It has primary operational responsibility for financial crisis management and is responsible for oversight of payment systems, settlement systems and clearing houses. It is also the UK's resolution authority.
- The Financial Policy Committee (FPC), with the Bank of England, will be responsible for contributing to the Bank of England's objective of protecting and enhancing the stability of the UK financial system, and, subject to that, supporting the economic policies of the Government, including its objectives for growth and employment. It will focus on identifying, monitoring and managing risk to the system.
- Her Majesty's Treasury (the Treasury) has overall responsibility for the UK's financial system, the institutional structure of financial regulation, and the legislation that governs it, both domestic and international.



⁴ More information on how firms will be split between the FCA and PRA is set out in this document: www.fsa.gov.uk/static/pubs/other/designation.pdf.

⁵ The PRA will have the power to deploy a veto where it considers that action we are taking may threaten financial stability, or cause the failure of a PRA authorised person in a way that would adversely affect financial stability.

The FCA and financial stability

The regulatory system that will be established when the Bill becomes law has the stability of the financial system at its heart:

- The FPC will be able to give directions, using its macro-prudential tools, to both regulators for the purpose of protecting and enhancing financial stability.
- The PRA's general objective requires it to consider financial stability in its regulation of PRA Authorised persons.
- The FCA's integrity objective includes within it the 'soundness, stability and resilience' of the UK financial system.

We believe that the FCA has an important role to play in contributing to financial stability, particularly through regulation of the financial and wholesale markets. In carrying out our functions, we will consider, where appropriate, what impact our actions could have on financial stability.

With regard to resilience, the FCA will expect firms to observe high standards in their operational risk management, having procedures in place to ensure continuity of critical services. Firms will be expected to comply with standards for resilience and recovery set in this area.

The Financial Services Bill 2012 (the Bill), which will bring these changes into force, has not yet completed its passage through Parliament and may be subject to further change. The Government's intention, however, is that the FCA's overarching strategic objective, as currently set out in the draft legislation, will be:

To ensure that the relevant markets function well

To support this, the FCA will have three operational objectives:

- To secure an appropriate degree of protection for consumers.

- To protect and enhance the integrity of the UK financial system.
- To promote effective competition in the interests of consumers.

We will put more responsibility on providers to ensure that products only reach the customers they were designed for.

Delivering good market conduct

To ensure that the relevant markets work well the FCA will increase its focus on delivering good market conduct. We will look at a wider range of behaviour which damages trust in the integrity of markets or threatens consumer protection. Our three key priorities in delivering good market conduct will be:

A renewed focus on wholesale conduct

We recognise that activities in retail and wholesale markets are connected and that risks caused by poor wholesale conduct can be transmitted between them. The failure to properly manage the often inherent conflicts of interest in wholesale markets is a root cause of risk to both market integrity and consumer protection. To enhance trust and confidence in the integrity of markets, we will take a more assertive and interventionist approach to risks caused by wholesale activities and, if necessary, will act to protect a wider range of client relationships than at present.

Trust in the integrity of markets

The FCA will not accept that there are some categories of relationship in which we should not be interested because the sophistication of the parties enables them to look after their own interests. In particular, we mean where poor behaviour has a wider impact on trust in the integrity of markets, or where charges and fees within wholesale markets are passed down to retail consumers.

Preventing market abuse

Good wholesale conduct relies on the effective policing of market abuse. Our approach to market conduct will reinforce the strong track record that we have built by tackling criminal and civil market abuse.

The Government intends to give the FCA new powers to help it achieve these objectives. Further information on some of these is set out below.

Product governance and intervention

One of the key lessons we have learned from previous market failures, such as payment protection insurance (PPI), is that it can be much more effective to intervene early; to pre-empt and prevent widespread harm to consumers from happening in the first place, rather than clear up after the event. We will do this by improving the way we gather intelligence (including listening to comments from consumer organisations and whistleblowers), creating a bolder organisational culture, and adopting a new style of supervision.

How product governance is developing

The FSA's *consultation on non-mainstream pooled investments*, published in August 2012, is an example of how work is developing in this area. This paper proposed the banning of the promotion of Unregulated Collective Investment Schemes (UCIS) and similar products to the vast majority of retail investors in the UK. This paper followed extensive work that found that three-quarters of advised sales of UCIS to retail customers were unsuitable.

For example, our new style of supervision means we will intervene earlier in a product's lifespan and seek to address root causes of problems for consumers. We will do this by scrutinising firms' product governance – how firms design, operate and sell products. This may include assessing, for example, whether the target consumers' needs were taken into account in the product design; whether there is sufficient product oversight and monitoring of practical outcomes for consumers; and whether the distribution strategies are appropriate. The work of the FSA looking at *retail product development and governance in the structured product review* is an example of how this is already being taken forward.

One of our new powers enables us to ban misleading financial promotions.

We believe, as the FCA, it will be necessary for us to have a greater focus on product governance. The FSA has already proposed turning existing guidance on provider responsibilities into rules to complement point-of-sale obligations and cover the entire distribution chain. This will set outcome-focused responsibilities on firms to govern the design and delivery of products in a way that delivers fair results.

Provider firms will be expected to have robust procedures to assess their target market, perform adequate stress testing, and manage the product risks for consumers. We would expect the sorts of standards that consumers associate with basic vehicle safety or over-the-counter medicines, for example, to be the norm for widely sold financial products. Firms should also consider making their own pre-approval processes more transparent; the aim should be to increase the level of trust consumers have in financial products.

The FSA's experience with many product mis-selling issues has been that products designed for a specific market were sold widely outside it. By putting more responsibility on providers to ensure that products only reach the customers they were designed for – and that they function as expected – there should be far fewer incidents of major consumer harm. It is likely we will go further than the FSA has previously done in challenging providers on the value-for-money of their products and checking that charging structures can still ensure good outcomes for consumers.

If necessary, we will be ready to intervene directly by making product intervention rules to prevent harm to consumers – for example, by restricting the use of specified product features or the promotion of particular product types to some or all consumers.

Under the Bill we have a clear mandate to make rules to ban products that pose unacceptable risks to consumers, subject to a consultation process. However, in cases where there is a need for prompt intervention, such rules can be made without consultation but will last for no more than 12 months. The Bill also introduces a new element that would allow us to make rules ensuring consumers get their money back if they are sold a product after a ban or restriction comes into force. This could offer a powerful deterrent to firms that are not acting in the interest of their customers.

In the FSA's *draft statement of policy for temporary intervention rules*, the intended approach is outlined and gives potential intervention scenarios where we may consider making these rules without consultation.

What this will mean in practice

We are likely to consider temporary product intervention rules, such as limiting the sale of the product, where it appears necessary or expedient because the delay involved in consultation would prejudice consumer interests. Where significant harm is possible from the ongoing sale of a product, we will act quickly to limit the extent of the harm.

When making temporary product intervention rules, our focus will be on consumer protection. We will, for example, take into consideration the potential scale of harm to individual customers, and whether issues may lead to harm for particular groups of vulnerable customers. When determining whether temporary product intervention rules may be made, we will consider whether products are being targeted at the wrong consumers, and whether the inclusion or exclusion of certain product features will create widespread consumer harm.

We will develop our policy on product intervention rules between now and Day One.

Product pre-approval

We have already explored the possibility of a product pre-approval scheme and have ruled it out as a possible intervention to have in place on Day One.

In response to feedback on a Discussion Paper on product intervention last year, the FSA said pre-approval would require a marked increase in regulatory resources. It could also lead consumers to assume that all products had been endorsed by the regulator and were therefore 'safe'. However, we recognise that product approval may have a place in particular circumstances.

Financial promotions

One of our new powers enables us to ban misleading financial promotions. This power means we can remove promotions immediately from the market, or prevent them from being used in the first place, without going through our enforcement process. By removing the risk of harm we help consumers; and other firms will benefit from a more transparent process.

The use of this new power will be determined by the specific promotion and not used against the firm as a whole. It can be used on its own or before we take enforcement action against a firm. It will work separately from our general disciplinary powers, which we will use when firms fail to comply with our rules and their overall systems and approach are poor.

The process we intend to adopt is highlighted in the diagram above. Following the third step, firms will be able to refer the matter to the Upper Tribunal if the FCA decides not to revoke the direction.

Using the new power is intended to help us to raise standards in a particular area, such as for new products, or relatively new channels like social media, as it will give a clear message to firms that are thinking of doing something similar.

The promotions where we use the power will not only be the worst cases, and we will not always measure harm to consumers in terms of actual or potential financial loss. We will also consider promotions that adversely affect consumers' ability to make informed choices and secure the best deal for themselves.

How the financial promotions power will work



This will allow us to be much clearer with the industry from Day One about what we expect, in a way that was not possible under existing legislation.

Publicising enforcement action

One of the new powers allows us to publicly announce that we have begun disciplinary action against a firm or individual. We will be able to publish details of a 'warning notice' proposing disciplinary action, to signal the start of formal enforcement proceedings. We will have to consult the recipient of the warning notice before publishing.

By being more open and transparent about our enforcement process, we will help consumers better understand the action we are taking on their behalf, and bring potential problems to their attention earlier. It also makes it clear to firms, and the market, as to what we consider to be unacceptable behaviour.

New powers on recognised investment exchanges, sponsors and primary information providers

We will gain new powers to help our regulation of markets, relating to recognised investment exchanges⁶ (RIEs), sponsors⁷ and primary information providers⁸ (PIPs). These will, in general, provide the same supervisory and sanctioning powers that exist in relation to investment firms. We will consult on our approach to these powers before Day One.

For RIEs, the changes will ensure we can react more effectively and respond to the complex and challenging environment that we, and exchanges, now face; we will also act faster to address compliance failures.

For sponsors, the Bill updates and extends the current powers by providing a more flexible set of tools, such as extending the power to impose financial penalties and suspend sponsors. This change reflects the importance of sponsors to the UK listing regime and the limited nature of what is currently available to the FSA to oversee them effectively and proportionately.

The Bill gives us similar powers in relation to PIPs, and places our regulation on a statutory footing, while increasing the limitation period for imposing penalties for rule breaches from two to three years.⁹

Super-complaints

Certain consumer organisations will be able to make what are known as 'super-complaints'. The aim is to provide consumer bodies with a way of raising competition and consumer issues with us, and is modelled on a similar process that already operates with the Office of Fair Trading.

⁶ A body authorised to operate an exchange for the trading of securities and derivatives in the UK, for example the London Stock Exchange.

⁷ Sponsors are advisers that must be approved by us to provide certain services to issuers of securities.

⁸ Primary information providers act as intermediaries passing regulated information from issuers to the secondary information providers, which then provide it to the public.

⁹ This will bring it into line with the limitation period elsewhere in the Financial Services and Markets Act.

We will look into the issues raised in the super-complaint and publish a response within 90 days, setting out how we have dealt with it and whether we have decided to take any action.

We will make the process straightforward for the organisations that may send in super-complaints and have put *draft guidance on the website* to show how the process may work.¹⁰ In early 2013 we will publish further details showing how to set out super-complaints and what we will do once we receive them.

Consumer credit

The Government proposes to transfer responsibility for consumer credit regulation from the Office of Fair Trading to the FCA, and will make its final decision in 2013.

As this progresses we will work closely with consumers, the industry and Government to develop proposals for effective regulation that helps the market to work well and seeks to ensure the fair treatment of consumers.

If the transfer goes ahead, we expect the FCA to take responsibility for consumer credit in 2014. This will be a challenging task, as many firms have credit licences, and we estimate more than half are currently not regulated by the FSA.

If the FCA takes on this responsibility, we will initially introduce an interim regime to make sure consumers are protected while we develop our full regime, which will likely be introduced in 2016. We will consult on our high-level proposals for consumer credit regulation in early 2013, and on the details of the regime in autumn 2013.

Competition

Competition on quality and price is vital in financial services. It creates incentives for firms to continually provide better products and services, helping to deliver innovation and choice to consumers. This matters especially in markets where the financial crisis has led to a reduction in competition.

The FCA has a competition objective and competition duty. These require us to identify and address competition problems and adopt a more pro-competition approach to regulation, recognising the potential of competition to advance all of our operational objectives.

We are in the early stages of developing our approach and set out our initial thinking here. If you have an interest in this area, we have set out some specific questions for response in the annex at the back of this document.

Promoting competition

The causes of poor competition are often complex, and in many cases arise from a combination of problems rather than one thing on its own. In retail banking, for example, some markets are highly concentrated. The Office of Fair Trading (OFT) and Independent Commission on Banking (ICB) have previously concluded that competition is ineffective for a variety of reasons, including people's reluctance to switch accounts, limited branch networks, and weak recognition of entrants' brands.

Recognising such problems, we will take a range of actions under our competition mandate, where needed, to bring about markets where:

- There are no undue barriers to entry or expansion. Competition in some markets is weak because it is difficult for new firms to enter the market or attract new customers.
- Consumer engagement with products and services drives competition. In some markets, weak competition is related to behaviour – for example, where people rarely switch products because of concerns about costs or hassle, or where some products are sold together so that consumers are less likely to explore potentially better options. We know there is a limit to how interested consumers will be in financial services products, and our approach to disclosure recognises this.

¹⁰ We will also receive referrals from bodies such as the Financial Ombudsman Service. These will not be known as super-complaints but we will have to follow a similar process – see page 49.

But the more consumers can be empowered, the greater buyer power they can exert, for example through shopping around and seeking the best deal.

- No single firm (or small group of firms together) dominates the market or can limit opportunities for competitors to grow market share. The nature or business model of potential competitors is also important for shaking up established patterns of competition and acting as a catalyst for change.
- Firms' conduct is focused on meeting consumers' genuine needs. We expect firms to focus their efforts on meeting these needs and attracting new customers; not seeking new ways to exploit weaknesses in consumer behaviour (for example, through the use of hidden charges).
- The regulatory framework minimises or limits other distortions to competition, such as those that may arise if firms can exploit their greater knowledge and understanding of products and markets. Such advantages in information may, for example, lead to consumers simply accepting what they are offered rather than shopping around and seeking out a better deal.

Embedding competition in our regulatory approach

To fulfil our competition objective, we will need to expand our analysis of markets. When this raises concerns about whether competition is effective in delivering value or quality or whether consumers are getting a fair deal, we will conduct a sound and thorough study of the market and, where possible, design pro-competitive remedies.

A market study will require different information from firms than the FSA currently collects, and must consider consumers' and firms' behaviour, the structure of the market, and pricing. To do this we will need to develop our skills and expertise in competition.

Our competition duty means that whenever we are working out how to advance our operational objectives we will consider doing so through promoting competition. We will weigh up the impact on competition of new measures we propose for dealing with a particular problem, using an enhanced approach to our market failure analysis.

When considering how to improve consumer outcomes, we will look at whether improving competition could get the same results as other action we could take instead. Our approach will recognise that while regulation that corrects underlying market failures is necessary for competition to deliver good outcomes for consumers, ill-designed or disproportionate regulation can prevent competition working well. We will look out for such regulation when carrying out post-implementation reviews and seek to replace it with pro-competition alternatives where appropriate.

If we decide to intervene to improve competition, we will be able to use the existing range of tools, including rule-making powers. Interventions in relation to competition are likely to be market-wide, covering suppliers of competing/substitute products. Our actions will be bold and wide-reaching, involving packages of measures that take account of the full range of problems in a market.

Where some causes of poor consumer outcomes fall outside our remit, or where a more radical remedy is required, we will use our power to refer problems to the competition authorities for review and possible action.

Our relationship with the Office of Fair Trading

We will strengthen the way we work with the Office of Fair Trading (OFT) and the future Competition and Markets Authority. Early next year, the FSA intends to publish a draft Memorandum of Understanding that sets out how the FCA and the OFT will develop our respective roles and how we aim to achieve a complementary and consistent approach.



CHAPTER 2:

PROTECTING THE PERIMETER

Our Authorisations Division is the FCA 'gateway' to regulated activities in the UK. At some point during their regulatory lifetime, all UK-regulated firms will engage with us. We expect to make around 40,000 regulatory decisions per year, to ensure that only the right firms, run by the right people, and selling the right products, to the right consumers, are approved to do business.

Our authorisation processes will be clear and straightforward. We will be open with firms and will make bold and timely decisions. The changes to our approach will be set out before Day One and built into the authorisation processes for both dual-regulated (PRA and FCA) firms and FCA-only regulated firms.

Ensuring the high quality of those who enter the industry is a key priority for us and is an effective way of helping to protect consumers, firms and markets from harmful behaviour and financial crime.

We will take forward the FSA's existing conduct requirements, which will continue to be both appropriate and necessary to achieving good outcomes for consumers and promoting competition.

We know, however, that there is a fine balance to be struck between ensuring high standards

at the gateway and making sure we do not stifle innovation and appropriate levels of access for new participants.

Review of barriers to entry

We have reviewed the conduct requirements that apply to new banks to ensure they do not pose excessive barriers to entry or expansion. As part of this, we have looked at whether we can make the authorisation process more manageable for firms, while still ensuring they meet the threshold conditions test, which aims to ensure the minimum standards for those doing business in the financial services sector. We will publish our proposals by the end of the year.

Dual regulation

When the FCA and PRA come into effect, they will have separate authorisation functions, but will have a single administrative process for dual-regulated firms.

Firms that are dual-regulated will apply to the PRA unless directed otherwise. When we make authorisation decisions, applications from dual-regulated firms will be considered by both the FCA and the PRA and will follow one of two processes set out below:

Consent:

when a firm applies to the PRA for authorisation or voluntary variation of permission or approved persons, our role will be to give or refuse consent to the PRA. If we do not give consent, the PRA must refuse the application. We will focus our assessment on the issues that have conduct implications, and we will accept the PRA's view of the financial soundness of the firm.

Consult:

when a firm applies for a change in control, a waiver which is materially important to our objectives, passporting, transfer of insurance business or cancellation of permission, the PRA must consult us. The PRA will take our response into account but will not be bound by our view.

We will work closely with the PRA to ensure these processes are as smooth and efficient as possible.

Practical points for firms

Firms and individuals who are already regulated by the FSA will not need to reapply to become regulated by the FCA and PRA. You will be automatically transferred to the appropriate regulator at Day One.

The *Consultation Paper* issued on 12 September set out details of how your firm can disclose its authorisation status.

Gabriel and ONA, our online systems for reporting regulatory data, and applications and notifications respectively, will continue to be used.

Firm reference numbers and individual reference numbers will remain the same.

There will be only one Register for all firms, as there is now. It will be accessed via the FCA and the PRA websites.

Applications made to the FSA but not completed by Day One will not need to be re-submitted. Your application will be transferred to the appropriate regulator automatically.

How to apply

If you are regulated by the FCA and PRA, or are applying for authorisation as a dual-regulated firm, you will not have to make duplicate applications to both regulators. You will get a single decision from either the FCA or PRA that reflects the decision of one or both regulators as appropriate.

- All paper applications for dual-regulated firms should be made to the PRA.
- All paper applications for FCA-only regulated firms should be made to the FCA.
- ONA submissions will be automatically routed to either the FCA or both the FCA and PRA.

Threshold conditions

When firms first apply for authorisation, or want to vary their permissions, they will be assessed against FCA threshold conditions, which will allow us to set the standards all

new entrants should meet and give us more power to challenge a firm about its business model and strategy.

We will assess FCA-only regulated firms for conduct and prudential issues. We will assess dual-regulated firms for conduct only, with the PRA assessing prudential issues.

We will work to these principles:

- We will align our assessments of new applications to the risk they pose to our statutory objectives; we will not authorise firms whose products and services pose a risk to customers.
- We will be open with all potential applicants as they go through the authorisations process, making sure we speak with people early on so they understand what is required of them.

- We will look closely at the proposed business model and the viability of the firm over a medium-term horizon.
- Our processes will be structured to support our operational objectives.
- We will refuse applications at an earlier stage if we do not think the proposed offering of products or services is in the interests of consumers or, more broadly, if it poses a significant risk to our objectives.
- We will share any risks and underlying themes that we identify with our supervision colleagues, so they can monitor and assess them on an ongoing basis once a firm or individual is authorised.

...it is vital for firms to have balanced and effective boards, with a competent senior executive team.

Business Model Threshold Condition

A new Business Model Threshold Condition will demonstrate the importance that we place on a firm's ability to put forward an appropriate, viable and sustainable business model, given the nature and scale of business that they intend to carry out.

We will expect firms to demonstrate adequate contingency planning in their business model. They will need to make clear how their business model meets the needs of clients and customers, not placing them at undue risk, or placing at risk the integrity of the wider financial services system, for example, from financial crime. We expect firms to provide clear information, with evidence of how they will meet this threshold condition. We will recommend refusal at an early stage where we are not satisfied that a firm meets, or will continue to meet, this minimum expected standard.

We will consult on how we will apply this Business Model Threshold Condition in a separate consultation paper due to be published in November 2012.

Approved persons

An 'approved person' is an individual who has been approved by the FCA or PRA to perform one or more 'controlled functions' on behalf of an authorised firm. These include significant influence functions (SIFs), such as a director or chief executive.

To ensure firms are effectively governed and able to deal with their customers fairly, only individuals with the appropriate skills, capabilities and behaviour should be appointed to these positions.

We think it is vital for firms to have balanced and effective boards, with a competent senior executive team. We will therefore consider the appropriateness of an individual's appointment to a board within the context of the board's overall composition.

We will continue to take a risk-based approach to approving individuals who perform controlled functions. For SIFs in higher-impact firms, we will continue to use SIF interviews where appropriate. When we assess an approved person application, we will look at the individual's personal integrity, financial soundness, honesty and record of treating customers fairly. We are prepared to accept individuals into controlled functions who have non-financial convictions that are spent. It is up to the firms that make the application to demonstrate to us that the individual is appropriate for the role.

The PRA will receive and consider applications relating to the most senior functions – such as chief executive or senior directors – for dual-regulated firms. We will either give or refuse our consent to those applications. We will ensure that conduct-related skills and experience are taken into account when assessing senior function applications.

Further changes to the Approved Persons Regime for dual-regulated firms may be needed; a *consultation* was issued in October 2012¹¹ on this and on the designation of specific functions between the two regulators.

As stated in that consultation paper, the FSA is considering what further enhancements to the Approved Persons Regime are needed for the FCA.

Change in control

Change-in-control applications are when individuals or corporate bodies wishing to acquire, increase or decrease control in a UK authorised firm have to seek prior approval from the FSA. Change-in-control applications for dual-regulated firms will be assessed by the PRA, which must consult us before deciding whether to approve or not. If we have concerns about money laundering or terrorist financing, we may require the PRA to reject the application regardless of its own view, or impose conditions that would address our concerns. Change-in-control applications for FCA-only regulated firms will be assessed by the FCA.

When assessing changes in control, we will ensure the firm's business model remains viable and that consumers will not lose out as a result of the change.

We will not accept a change in control where we have significant concerns about the controller's integrity or reputation. We will adopt a different approach where the proposed controller is known to us and there are no outstanding concerns.

If we are not told about a change in control until after the event has happened, we will consider taking appropriate action, up to and including prosecution.

Waivers

As is the case now, in some exceptional circumstances we will be able to put aside ('waive') rules for certain firms if they are able to demonstrate that they can meet our statutory test, which we explain in the orange box.

Firms should apply to the FCA to waive FCA rules, and to the PRA to waive PRA rules.

We will consult with the PRA where we intend to waive a rule that may be materially relevant to the PRA's objectives.

We will consider granting a waiver if the applicant is able to demonstrate that:

- **compliance with the rule would be unduly burdensome or would not achieve the rule's purpose; and**
- **the direction would not adversely affect the advancement of any of our operational objectives, which are:**
 - **to secure an appropriate degree of protection for consumers;**
 - **to protect and enhance the integrity of the UK financial system; and**
 - **to promote effective competition in the interests of consumers.**

Passporting

'Passporting' rights allow authorised firms in the European Economic Area (EEA) to do business in another EEA Member State under a single market directive. UK-authorised firms that wish to carry out regulated activities within the EEA may do so by either physically establishing a branch or engaging an agent in a host Member State, or providing their business remotely through cross-border services.

Passporting also enables authorised firms from another EEA Member State to do business in the UK via an establishment or services passport. In most cases, passporting rights can be exercised following notification procedures set out in the relevant single market directive.

For firms wishing to passport into the UK, we will manage all passporting notifications except for banking and insurance¹², which will be managed by the PRA.

For firms wishing to passport out of the UK, we will be responsible for issuing relevant notices for those authorised firms that are not PRA regulated. If an FCA firm that is part of a group wishes to passport, we will consult with the PRA in the event the wider group includes a PRA-regulated firm.

When firms wish to establish themselves in the UK, we will assess them based on conduct risks, EU directives and adherence to local rules. We will analyse the types of business that we think hold more risk for consumers and UK markets.

For dual-regulated firms, both the FCA and the PRA will maintain a relationship with the relevant EEA regulator.

E-money firms, Payment Services Directive firms, and mutuals

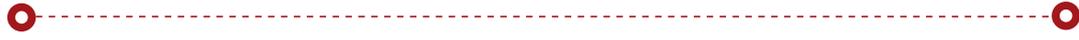
The Bill will not make any changes to applicants seeking payment or electronic money institution status. On Day One, these businesses will be regulated solely by the FCA. From 1 October 2012 the FSA began to conduct 'fit and proper tests' on applicants who wish to become registered as small payment institutions. These tests also apply to existing registered small payment institutions and certain individuals attached to them.

The vast majority of the 10,000-plus mutual societies will continue to be unregulated; we will assume responsibility for their registration and public records and for receiving their annual returns.¹³ For those mutuals (such as building societies, credit unions and some friendly societies) that are currently regulated under FSMA¹⁴, the FCA will also become their registration authority.

¹² Those that come under the Banking Directive, Consolidated Life Assurance Directive, Reinsurance, and Third non-life insurance Directives. The insurance directives will in due course be replaced by Solvency II.

¹³ For more information on our role here, see: www.fsa.gov.uk/doing/small_firms/msr

¹⁴ The Financial Services and Markets Act 2000.



CHAPTER 3:

ENSURING FIRMS CONTINUE
TO MEET OUR STANDARDS

We will be the conduct supervisor for approximately 26,000 firms across all industry sectors and the prudential supervisor for approximately 23,000 firms not regulated by the PRA.

Our new approach will be to carry out in-depth, structured supervision work with those firms with the potential to cause the greatest risks to our objectives. This means there will be fewer supervisors allocated to specific firms; but this will allow us greater flexibility to carry out more reviews on products and issues across a particular sector or market. This will enable us to take action faster on our priorities and what we believe are the biggest conduct risks.

Essentially, we will be looking for firms to base their business model, their culture, and how they run the business, on a foundation of fair treatment of customers...

The new approach will be underpinned by judgement-based supervision. This means that we will be making supervisory judgements about a firm's business model and forward-looking strategy, and will intervene if we see unacceptable risks to the fair treatment of customers. Essentially, we will be looking for firms to base their business model, their culture, and how they run the business, on a foundation of fair treatment of customers as set out in the Treating Customers Fairly (TCF) initiative. While we recognise that firms need to be sustainable, we will not let a firm compromise fair treatment of customers to achieve financial success.

Equally, we will be open to innovation in the industry and encourage long-term growth in the sector because it is vital to the health of the wider UK economy. We must allow firms to develop new models of doing business and we will want to see plans and strategies that ensure firms' sustainability and healthy returns. The importance of firms' innovation

and growth will run throughout our supervisory approach to all firms. Whether we are conducting an in-depth look at a firm's business model, or a thematic review of a selling practice or product, we will aim to ensure our actions strike the right balance between all our statutory objectives.

We will act more quickly and decisively and be more pre-emptive in identifying and addressing problems before they cause harm, with our senior staff involved in supervision issues at an earlier stage. We will deliver this through a risk-based and proportionate approach, recognising the diversity among firms and markets. These changes, which includes replacing the Arrow risk assessment framework, will take time to fully roll out, and early next year we will give firms a high-level timetable on when to expect changes.

This approach also means that we will focus our attention on the bigger issues, either in individual firms or within and across sectors, and have a more open, engaged and challenging approach with firms at the senior management and board level.

Looking at competition

Our supervision function will play a key role in relation to competition, starting from when we gather intelligence and identify risks, and running through to when we decide how to act to tackle the problems we find. We will make use of intelligence and information from a variety of sources, including from firms, consumer groups and competition regulators. When carrying out analyses of business models and strategy, we will take account of a firm's competitive position in various markets when assessing the potential conduct risks that may arise from their strategies. The FCA will also carry out studies of markets, when our intelligence indicates competition is not functioning well. Key to this will be to develop our skills and expertise on competition.

Categorising firms

The starting point in describing how we will supervise a firm is to say which one of our four conduct supervision categories the firm falls into: C1, C2, C3 or C4.

The list of firms in each category is still to be finalised but essentially it means:

C1: banking and insurance groups with a very large number of retail customers and universal/investment banks with very large client assets and trading operations

C2: firms across all sectors with a substantial number of retail customers and/or large wholesale firms

C3: firms across all sectors with retail customers and/or a significant wholesale presence

C4: smaller firms, including almost all intermediaries

Firms are categorised according to their potential impact on our objectives. The category we place a firm in determines the style of supervision we will carry out.

Our categorisation will use a combination of current impact measures, retail customer numbers and some measures of market impact.

We will take a similar approach to categorising firms for prudential supervision. We will write to firms in early 2013 to let them know which category they will be in.

C1 and C2 firms will be classed as 'fixed portfolio', which means they will have a nominated supervisor. The vast majority of firms will be C3 and C4 firms and classed as 'flexible portfolio', which means they will be supervised by a team of sector specialists and not have a nominated supervisor – just as the FSA currently supervises smaller firms. Our heads of supervision will also have responsibility for specific sectors,

and will engage with groups of firms and trade associations, as appropriate, to gain a more in-depth understanding of specific sectors, along with building an open and transparent relationship.

Overall, the new categorisation means we will have supervisors allocated to firms with the greatest potential to cause risks to consumers or market integrity. For FCA-only regulated firms, we will also take into account the impact their failure might have. Ultimately, some firms will no longer have a dedicated supervisor. This will allow us to have more supervisors who can be deployed to deal with problems that arise and specific issues or products that are causing consumers harm or have the potential to do so.

How we will supervise firms

Some firms in some sectors may experience a highly intensive level of contact with supervisors over months or even years. Others may only be contacted by one of our supervisors once every four years. The point is, we will focus our attention on firms and sectors of the industry that could cause, or are causing, consumers harm or threaten market integrity.

Our supervision model is based on three pillars:

- 1. Firm Systematic Framework (FSF) –** preventative work through structured conduct assessment of firms.
- 2. Event-driven work –** dealing faster and more decisively with problems that are emerging or have happened, and securing customer redress or other remedial work where necessary. This will cover issues that occur outside the firm assessment cycle, and will use better data monitoring and intelligence.
- 3. Issues and products –** fast, intensive campaigns on sectors of the market or products within a sector that are putting or may put consumers at risk.

This approach is driven by what we call sector risk assessment, which looks at what is currently and prospectively causing poor outcomes for consumers and market participants. It will use data analysis, market intelligence and input from the firm assessment process, as well as working closely with our new Policy, Risk and Research area (see Chapter 5).

1. The Firm Systematic Framework (FSF)

This is designed to assess a firm's conduct risk, and aims to answer the question:

Are the interests of customers and market integrity at the heart of how the firm is run?

It will do this by using a common framework across all sectors, which is targeted to the type of firm. The common features involve:

- **Business model and strategy analysis (BMSA):** to give a view on how sustainable the business would be in respect of conduct, and of where future risks might lie – linking to the Business Model Threshold Condition check we will carry out at the authorisations stage.

- **Assessment of how the firm embeds fair treatment of customers and ensures market integrity** in the way it conducts its business. The assessment has four modules:

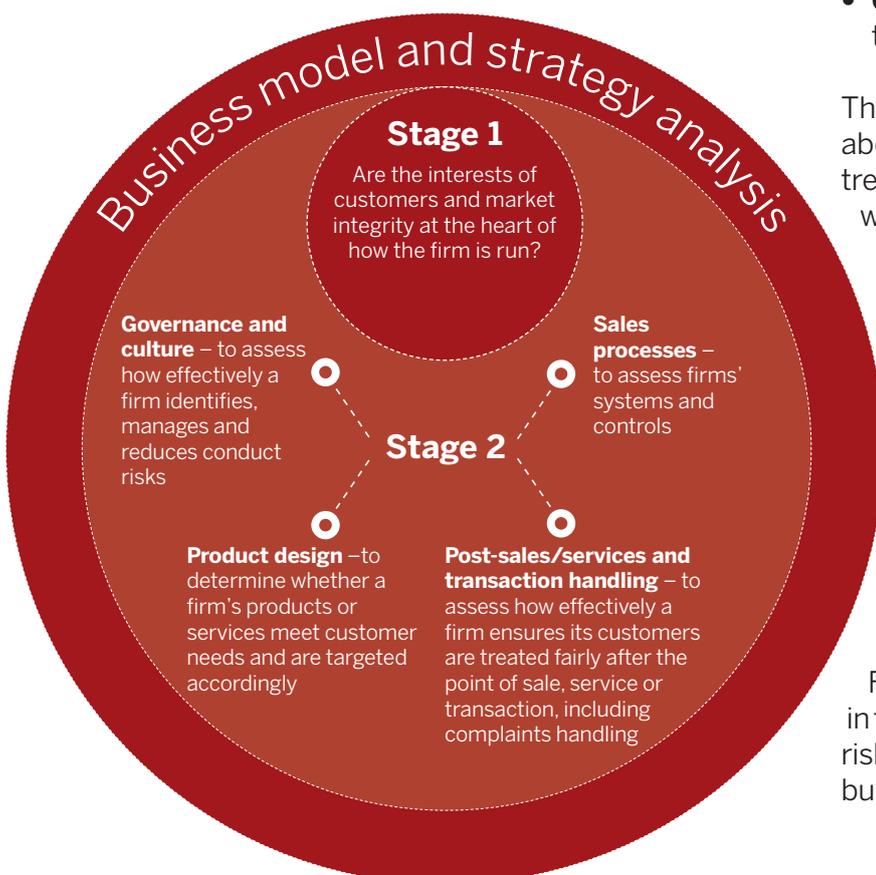
- **governance and culture** – to assess how effectively a firm identifies, manages and reduces conduct risks;
- **product design** – to determine whether a firm's products or services meet customer needs and are targeted accordingly;
- **sales or transaction processes** – to assess firms' systems and controls; and
- **post-sales/services and transaction handling** – to assess how effectively a firm ensures its customers are treated fairly after the point of sale, service or transaction, including complaints handling.

- **Deciding what actions are required by the firm** to address issues we have identified.

- **Communication to the firm**, setting out the assessment and actions required.

The assessments will help us come to a view about the extent to which the firm embeds fair treatment of customers and integrity in the way it is run. This, at the most intensive end of assessment, covers the product lifespan from design through to sales and after-sales handling. The assessment of governance and culture will be crucial, as these are key factors that drive whether a firm treats its customers fairly and can achieve the consumer outcomes set out through the TCF initiative.

For **C1s**, we will carry out firm-by-firm business model and strategy analysis, in the context of the market they operate in. For **C2s**, we will take a group of similar firms in the same industry sector to identify common risks. For **C3s**, we will look at a sample of firms' business models across a sector.



Changes from current Arrow approach

Arrow	Firm Systematic Framework
Point-in-time assessment	Form of continuous assessment for C1 and C2 firms
Primarily issues-based – i.e. discovery work on issues considered to be higher risk	Assessment of key drivers of conduct risk, with work targeted by BMSA
Assessment results in letter and risk mitigation programme that frequently has many actions	Assessment results in letter and risk mitigation programme focused on a few key areas to be addressed
Extensive follow-up work by supervisors	Follow-up work done by firm with greater use of section 166 powers

The business model analysis will lead us to decide which of the FSF assessment areas to prioritise. For **C1s** and **C2s**, we will follow the analysis by working through the assessment areas on a two-year cycle.

Through the FSF, we will assess how firms manage the risks they create and identify the root causes of what leads to these risks. We will also want to understand consumers' actual experiences of dealing with firms.

The assessment modules will take place through interviews between supervisors and the firm to look at processes in relevant areas – detailed testing will not be used unless it is the only way to assess a particular risk. We will focus on the biggest problems firms need to tackle, and will prioritise actions; this may mean that firms have fewer risk mitigation programme (RMP) points than now.

Case study: example of how the FSF might work

Issue: the BMSA for a large retail group identifies that it has aggressive growth plans for sales of a new protection product, but a poor track record for its sales practices in this area. We judge the product to have a high potential for unsuitability for parts of its target market. On the basis of this analysis, the supervision team runs FSF modules covering **Product Design** and **Sales Process**.

Action taken: before the firm can sell the new product, we require the group to carry out a full root-cause analysis of its prior conduct in this area and to use this to enhance its business plan and implementation strategy for the product. We want the group to ensure that fair treatment of customers has been considered as an integral part of the strategy.

We monitor the effectiveness of the group's remedial actions as part of the continuous assessment process, and consider it alongside other contact with the firm such as issues and product reviews. This gives our supervision team the ability to identify root causes underlying the emergence of issues, and to require the group to address them as a whole.

How this differs from the previous FSA approach: in the past the FSA would not have intervened at this early stage, because it would not have had the continuous business model analysis and assessment from which to identify the issue. The FSA would have conducted sampling after the product launch, and ultimately would have required the firm to take remedial action, including redress to customers if something had gone wrong.

We will put the responsibility on firms to do their own monitoring on some of the less important points and to self-attest that they have been addressed. We will use a number of tools to ensure this happens, such as section 166 skilled person's reports, internal audit review and non-executive director reports.

We will examine **C3s'** business models, but will be looking more at the firms which are outliers compared to their peers. The assessment for **C3s** will be a focused review of their business, how it is run and how it is controlled. The FSF for these firms will be on a four-year cycle, but we will conduct interim reviews of firms where information indicates that the risk they represent is significantly changing.

C4s will also have their business models assessed when we look at how the firm runs its business, but this will be a lighter assessment than for C3s. We will want to see how firms identify and take action to reduce risks to their business. The FSA has already embarked on this approach, known as the Revised Approach to Small Firms Supervision (RASFS). This builds on the work with smaller firms to assess how they achieve the six consumer outcomes set out in the TCF initiative. The FCA will expect smaller firms to continue to strive to achieve these outcomes.

The RASFS programme is being implemented very similarly to how we previously assessed smaller firms. We intend having a 'touch point' with all C4 firms once every four years. This could range from a roadshow, an interview, a telephone call, an online assessment, or a combination of these. The exact interaction will depend on our assessment of the risk such firms pose to our objectives. To help us do this we are developing a risk-profiling tool to assess the risk to consumers each smaller firm could pose. These scores are based on the online reports firms submit through Gabriel, along with other data sources such as information from firm visits or our contact centre. All firms deemed to be 'high risk' and around 25% of firms deemed to be 'medium-high risk' will have a face-to-face interview. We will

give verbal feedback at this interview, followed by a letter setting out any remediation points, which will need to be addressed by the firm's senior management. Firms deemed to be 'high risk' after the interview will be subject to a follow-up supervisory visit. Those deemed to be lower risk may only be required to complete a formal online assessment once every four years. We will carry out visits to some of these firms to verify the results of this assessment.

2. Event-driven work

Having fewer supervisors allocated to specific firms means that we will have more flexibility to devote resources to situations in firms where there is heightened risk to consumers; or where consumers have experienced some loss and we need to act quickly to stop the situation from worsening.

Case study: example of event-driven supervisory work

Issue: a financial advice network tells us it intends to acquire another firm operating in its sector.

Action taken: the case is passed to a supervision team to assess the appropriateness of the acquisition from a conduct perspective. The team identifies weaknesses in the network's controls over its appointed representatives and asks for improvements. The acquisition is put on hold until the firm can demonstrate that its controls are sufficient to ensure its customers will be protected.

How this differs from the previous approach: our assessment will be focused on the risks associated with the firm's conduct and, in particular, how the acquisition may affect the firm's treatment of its customers. The FSA will have mainly focused on whether the acquisition risked the network firm's financial stability.

Case study: example of issue and product work

Issue: market intelligence suggests that a product is sold to customers who do not need it or do not fully understand it. We quickly make further enquiries and discover that the product may have been mis-sold, and that this is likely to have caused loss to those customers.

Action taken: we design a thematic project to look across the firms selling this product consistently, with input from the firms themselves and other industry participants. Our project quickly identifies some mis-selling. We immediately ask firms to stop any further sales of the product, and we take action to ensure that firms rapidly pay out redress to the appropriate customers. We ask the appropriate significant influence function holders to confirm to us these actions have been taken.

How this differs from the previous FSA approach: there are a number of differences that highlight our change in culture. In this case we are:

- acting on market intelligence earlier from a wider range of market participants, including consumers, trade bodies and individual firms;
- more willing to act on some hard evidence, rather than waiting for a comprehensive search for all possible evidence; and
- more willing to engage with the industry and trade bodies at an earlier stage.

As a result, initial identification work, and remediation, will take place more quickly. Where appropriate, we will require the whole sector to consider the need for remedial action. We will place the onus on firms and their significant influence function holders to complete remediation without ongoing regulatory intervention.

Our response could be prompted, for example by a whistleblower alleging misconduct in a firm, or a spike in reported complaints at a firm. We will have a consistent and efficient process to ensure that 'event-driven' cases are dealt with quickly and we get the right outcomes for consumers.

3. Issues and products

Being more flexible in how we deploy supervisors means we can react promptly to emerging issues, and carry out more reviews on products and issues across a sector or market.

We will use a sector risk assessment (SRA) to drive this issue and product work. As the name suggests, this will provide an assessment of the conduct risks across a sector (such as the investment intermediary sector, or the retail banking sector). This will complement our firm-specific work, so together they identify risks, whether they are cross-firm issues, firm-specific issues or product issues.

Working with colleagues from across the organisation, we will use a range of data, information and intelligence from firms, consumers and trade bodies for example, to help us identify the biggest risks and to prioritise our work.

The key questions we will use the SRA to answer are:

- what are the cross-firm and product issues that are behind poor outcomes for consumers or endanger market integrity?
- what is the degree of potential harm?
- what is the discovery or mitigation work proposed?

Specialist sector teams will work together to deliver these assessments, making appropriate use of external data and market intelligence.

We will consider the full range of mitigation options before deciding what to do, including policy, competition, enforcement and other interventions, in addition to or instead of a wholly supervision-based response.

If we identify sector risks, we will carry out cross-firm issue and product work. This is where firms will experience a more intrusive approach, with specialist supervisors spending more time on a single issue and delving deeper into information, including but not limited to files, recordings of calls from customers, and mystery shopping in firms' high street branches and offices. We will look for the root causes of issues that we find, rather than just focusing on the effect they have.

Wholesale conduct supervision

Our focus on achieving a better deal for consumers and sound, stable and resilient markets provides the opportunity to adjust our approach to wholesale conduct, between counterparties and professionals – whether in the securities, banking or insurance markets.

We do not believe there is a clear divide between 'retail' and 'wholesale' markets. Our approach will recognise that activities in retail and wholesale markets are connected and that risks caused by poor conduct can be transmitted between them. What may start with institutional or wholesale relationships often affects retail consumers, and this interaction is relevant

Our approach will recognise that activities in retail and wholesale markets are connected and that risks caused by poor conduct can be transmitted between them.

to both our consumer protection and market integrity objectives. So good wholesale conduct relies on effective policing of market abuse, but consumers also need to be protected against activities which exploit differences in expertise or market power.

Poor wholesale conduct is not a victimless act simply because it takes place between sophisticated market participants, and it is not limited to criminal behaviour such as fraud or market abuse. It also captures a wide range of activities that exploit differences in expertise or market power to undermine trust in the integrity of markets or cause harm to retail consumers.

Misconduct in wholesale markets can have a much wider impact on the integrity of, and trust in, markets than a narrow interpretation of the principle of 'caveat emptor'¹⁵ may suggest. To enhance trust and confidence in the integrity of markets, we will take a more assertive and interventionist approach to risks caused by wholesale activities and, if necessary, will act to protect a wider range of client relationships than at present. For example, the poor behaviour by banks, recently revealed in relation to the part they play in setting benchmark rates, has had a widespread impact on trust in the Libor-setting process, even though this has limited direct impact on retail relationships.

Our approach in this area means that we will:

- See wholesale conduct as covering a range of activities and relationships in the banking, insurance and securities markets.
- Seek to ensure that wholesale markets are sound, stable, orderly and resilient and that consumers, whether retail or wholesale, enjoy an appropriate degree of protection from risks arising from their exposure, either directly or indirectly, to wholesale activities.

¹⁵ 'Caveat emptor' is used in this context to describe the extent to which sophisticated market participants can be expected to safeguard their own interests.

- No longer accept that there are some categories of relationship in which we should not be interested because the sophistication of the parties enables them to look after their own interests. In particular, we mean where poor behaviour has a wider impact on trust in the integrity of markets, or where charges and fees within wholesale markets are passed down to retail consumers.
- Continue to recognise the differing degrees of experience and expertise that different consumers may have (and the different degrees of protection offered by current client categorisation rules), but intervene more assertively to supervise existing rules governing the conduct of wholesale participants dealing with each other.
- Look at the possible impact on retail consumers of poor conduct in wholesale markets, even when the linkage is indirect – such as structured products that originate in investment banks, but are then packaged and sold in the retail market.

To apply these principles to how we supervise firms, we will use the same supervisory approach for wholesale activities as for retail,

made up of an FSF, issues and product work, and event-driven work. We will use a single FSF to cover all types of firms, considering potential harm to consumers and impact on market integrity arising, in particular, from the failure to identify and manage conflicts of interest.

We will have additional wholesale conduct modules in the FSF for a limited number of insurance, banking and investment C1 and C2 firms (around 30 firms). The modules are yet to be finalised, but are likely to be:

- product design and pre-sales/transaction;
- sales and transacting; and
- post-sales/transaction and ongoing provision of services.

This will be accompanied by more thematic work on key risks and priorities. However, **wholesale C3 and C4 firms**, which could include large international banks with a smaller wholesale presence in the UK, will not be subject to the same form of regular assessment as retail firms. They will be supervised mainly through issues and products work.

Case study: example of wholesale conduct

Issue: the FCA learns that a wholesale market participant is making additional income by misrepresenting the prices at which individual trades are executed to a professional client during the restructure of a portfolio.

Action taken: a supervision team investigates the quality of disclosure between participants and evaluates several potential actions, including the potential for a skilled person report and formal enforcement action. The supervisors also recommend a cross-sector thematic review to evaluate whether other firms may be exposing clients to similar detriment or if there is the option to deploy additional regulatory tools, including changes to rules or industry guidance.

How this differs from the previous supervisory approach: we will recognise the need to protect a wider range of client relationships where there are differences in sophistication or expertise, despite the client being classified as professional. Some clients are not necessarily equipped to police execution quality and prevent harm to themselves or their underlying clients, who are often the ultimate end-investors. Instead of allowing firms to shield themselves behind the principle of 'caveat emptor', we will conduct more systematic supervision to facilitate earlier intervention to prevent poor conduct leading to consumer harm or loss of trust in the integrity of that particular market.

Like retail firms, however, they will be subject to an assessment if information indicates that their risk profile has significantly increased. We are considering whether there should be some form of contact on a four-year basis through an online assessment. These firms will have one designated senior contact within the relevant supervision team.

Prudential supervision of FCA-only firms

Although the PRA will have prudential responsibility for all deposit takers, insurers and significant investment firms, we will have prudential responsibility for other sectors across the financial services industry.

Our general approach to prudential supervision will be based on managing failure when it happens rather than focusing on reducing its probability – this is because isolated failures of FCA-only firms would not generally present a risk to the integrity of the financial system. With the exception of a small number of prudentially critical firms, where we will continue to actively work to reduce their probability of failure, our focus will be on reducing the impact on customers and the integrity of the financial system of firms failing or being under financial strain. This is consistent with the PRA’s approach to firm failure – where we concentrate on mitigating the impact of failure on consumers and the PRA concentrates on mitigating the impact of failure on the stability of the financial system.

Our focus will be on ensuring that client assets are protected and that a firm can be run down without adversely affecting

Our focus will be on ensuring that client assets are protected and a firm can be run down without adversely affecting consumers.

Our focus will be on reducing the impact on customers and the integrity of the financial system of firms failing or being under financial strain.

consumers. However, we recognise that pre-failure, firms under financial strain can change their behaviour towards customers. We will identify instances where firms that are failing could cause further but avoidable harm to their customers, and will consider these as part of the event-driven process for possible action.

The type of supervision depends on the nature of the firm:

Prudentially critical firms (CP1), are firms where a disorderly failure would have a significant impact on the market in which they operate (for example, because a particular market is highly concentrated, so that a disorderly failure of one player could not easily be assimilated by the others, and/or where there are significant client asset and money holdings).

Prudentially significant firms (CP2), are firms where a disorderly failure would have a significant impact on the functioning of the market in which they operate, but there is a smaller client asset and money base or an orderly wind-down can be achieved.

Prudentially insignificant firms (CP3), are firms where failure, even if disorderly, is unlikely to have significant impact.

Making this approach work involves undertaking a form of prudential analysis to identify firms that are under financial strain.

For CP1 firms, there will be a full review of Internal Capital Adequacy Assessment Processes (ICAAP) and Individual Liquidity Adequacy Assessments (ILAA), where applicable, if they are Markets in Financial Instruments Directive (MiFID) investment firms subject to the Capital Requirements Directive (CRD); and a review of firms’ risk management practices. We will want to set Individual Capital Guidance at the minimum of the going-concern requirement or the orderly wind-down requirement – whichever is the greater.

Protecting client money and assets

Our responsibility for client money and asset regulation will cover all the firms we regulate, even those whose prudential supervision is led by the PRA.

We will continue to work with others here and in the EU to strengthen the regulatory framework for the protection of client assets, so people know that they are protected when they entrust money or assets to a firm. We will assess compliance in our supervision of firms, and base all of our work on robust risk analysis and better quality data.

We will also want to have a satisfactory wind-down plan from the firm.

For CP2 firms we will undertake very limited going-concern supervision and will only undertake a review of ICAAPs and ILAAs, if they are MiFID investment firms subject to the CRD. Most of our supervisory focus will be on satisfying ourselves that the wind-down plan is achievable and that the firm holds a minimum level of financial resources to fund an orderly wind-down.

For CP3 firms, we will be monitoring firms against minimum requirements and only stepping up supervision when a firm is close to failure or failing.

The tools that may be available to us in the event of insolvency are:

- Normal administration – this will be used for failures in most smaller firms which do not hold client assets.
- Special Resolution Regime (SRR) – this is currently only available for banks but, subject to consultation, the Treasury is proposing to widen it to cover investment firms (and other bodies). This would mean

that we could, if an investment firm failed to meet threshold conditions, ask the Bank of England (as the resolution authority) to conduct a joint impact assessment and operate the SRR to resolve a firm – providing it meets the tests of the SRR.

- Special Administration Regime (SAR) – this can be used for investment firms that hold client assets, and is likely to be our preferred tool for these firms. We will consider, with the Treasury, whether the applicability of the SAR could be widened beyond investment firms when it is reviewed in due course.

European and global context

We intend to continue to actively play our part in shaping EU and global financial services conduct and markets regulation. We will share information and support cross-border supervision in international supervisory colleges for large multi-national financial institutions, and coordinate with the PRA and others in our engagement with the European Supervisory Authorities and other European and international bodies.

Dual regulation

The *draft Memorandum of Understanding (MoU)* between the FCA and the PRA sets out the two key principles for supervisory cooperation and coordination for dual-regulated firms, namely that:

- Each regulator's supervisory judgements will be based on all relevant information.
- Supervisory activity will not normally be conducted jointly.

We intend to continue to actively play our part in shaping EU and global financial services conduct and markets regulation.

We will coordinate with the PRA to exchange information that is relevant to our individual objectives, but will act separately when engaging with firms – this reflects the independent but coordinated regulation as set out in the MoU.

We aim to ensure the right information is shared with the relevant body at the appropriate time, through a combination of a collaborative culture and staff who are familiar with the priorities of the other regulator; underpinned by clear processes. The international supervisory colleges mentioned above will be an important part of this.

The supervisors of each regulator will make their own, separate, regulatory judgements against their respective objectives. We will coordinate with the PRA to exchange information that is relevant to our individual objectives, but will act separately when engaging with firms – this reflects the independent but coordinated regulation as set out in the MoU.

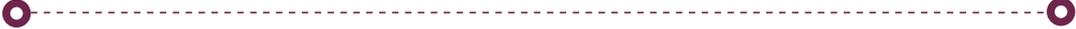
With-profits

An example of an issue on which we will cooperate with the PRA is the supervision of insurers with with-profits business. The FCA and the PRA will co-ordinate their supervision of insurers under the framework set out in

the FCA/PRA MoU. Special arrangements are needed for with-profits policies because the returns are not well defined, and are at the discretion of the insurance companies. A separate MoU will set out how the FCA and the PRA will work together in order appropriately to protect the interests of with-profits policyholders.

As part of its continuous assessment of the insurer's financial resources, the PRA will seek to ensure that any discretionary benefit allocations or other changes with financial implications that the insurer has proposed are compatible with its continued safety and soundness. We will have responsibility for monitoring whether the proposed changes are consistent with the insurer's previous communications to policyholders, our conduct rules and the insurer's overriding obligation to treat customers fairly.

There may be circumstances where the proposed discretionary benefit allocations call into question the safety and soundness of the firm as a whole and so its ability to meet its obligations to policyholders generally. In such circumstances, the PRA will work with the insurer and us to explore alternative ways those allocations could be made without materially impairing the insurer's safety and soundness. If no reasonable alternative exists, and given the risk to the insurer's overall safety and soundness, the Bill gives the PRA the power to take action to prevent such allocations being made. Where the PRA is satisfied that the insurer's decisions, or our requirements, do not affect the overall safety and soundness of the firm, the PRA will not take action.



CHAPTER 4:

TAKING ACTION AGAINST
FIRMS THAT DO NOT MEET
OUR STANDARDS

Strong and decisive enforcement will be vital to help make sure firms put consumers at the heart of their business and markets are sound, stable and resilient. The agenda of credible deterrence will remain central to our enforcement approach.

As it is often the most public action we take, enforcement will help reinforce and promote our priorities, and we will aim to get better outcomes for consumers from the financial services industry.

We will build on the progress already made and we are committed to:

- bringing more enforcement cases and pressing for tough penalties for infringements of rules;
- pursuing more cases against individuals and holding members of senior management accountable for their actions;

- pursuing criminal prosecutions, including for insider dealing and market manipulation in appropriate cases; and
- continuing to prioritise getting compensation for consumers.

We will take robust action to tackle unauthorised business, working closely with other agencies, and keeping consumers informed about the dangers they face from these firms.

In addition to the new powers available to us, there will be changes to our culture and in how likely we are to pursue action.

In particular, we intend to work more closely with other FCA departments to address the causes of problems and to prevent risks from materialising, alongside taking action once poor conduct has occurred and problems have arisen.

Building on the FSA's enforcement work

More cases and tougher penalties

- The three largest FSA fines on firms and the three highest on individuals have all been issued in the last two years.
- The FSA issued its largest penalty to date with a £59.5m fine on Barclays in June 2012.

Pursuing cases against individuals

- In the 2011/12 financial year, the FSA levied over £19m of fines on individuals, over twice the amount of the previous year.

Seeking criminal prosecutions for insider dealing and market manipulation

- The FSA has brought an increasing number of criminal cases to trial and secured 20 criminal convictions for insider dealing since 2009.
- This year the two largest and most complex criminal cases to date concluded, resulting in nine custodial sentences.

Getting compensation for consumers

- The FSA secured over £150m in redress for consumers in 2011/12 and also consulted on our first industry-wide scheme to seek redress for consumers who were mis-sold Arch Cru investment funds. This is in addition to the £5.9bn repaid since January 2011 to customers who have complained about how PPI was sold to them, and the agreement we have with banks to review past sales and provide redress on interest rate hedging products.

Taking action against unauthorised business

- Over the past 18 months, the FSA has disrupted approximately 1,675 firms involved in unauthorised investment activity.
- Since 2011, FSA action has closed down 25 schemes that had taken £330m from consumers, securing £33m back for victims, with 13 injunctions to shut down unauthorised businesses and freeze assets; six criminal proceedings begun; and five individuals convicted.

Enforcement will play a key role in supporting the FCA's desire to identify potential problems at an earlier stage, and take steps to avert them.

We will take action, including enforcement action, where we consider that particular aspects of a firm's business model or culture – such as its product selection, training and recruitment or remuneration practices – are likely to harm consumers. We will also place more emphasis, at an earlier stage, on securing redress where consumers have suffered harm.

This new approach has already begun and has led to the FSA successfully taking faster action in cases of suspicious market activity as a result of closer cooperation between the Enforcement and Market Monitoring teams. We will seek to replicate this in other areas, for example by supporting the new Policy Risk and Research team to work across the business to ensure our Enforcement team is in a position to investigate on the basis of the latest market intelligence.

While we will continue to rely on our enforcement work to help deliver clean markets and combat market abuse, we will aim to help combat fraud in the financial sector by working closely with other law enforcement agencies.

To do all of this, we will use the full range of our enforcement powers, which include the ability to fine, suspend, prohibit, seek injunctions, order compensation to be paid and bring criminal prosecutions.

How we will work with the PRA

Before taking action against dual-regulated firms, we will consult with the PRA. If an issue is relevant to both of us, we will decide whether it is best for us to pursue a joint investigation, or for one of us to act on our own, keeping the other informed along the way. In limited circumstances, we may each lead separate but coordinated investigations.

Being more transparent in our enforcement process

We will also seek to be more transparent about our work and we will publicise, to the extent that it is legally possible, cases where we have intervened but formal action has not been taken.

One of our new powers means we can publicly announce that we have begun disciplinary action against a firm or individual (see Chapter 1).

Decision making

The Financial Services and Markets Act 2000 will require the FCA to publish the procedure that it proposes to follow when giving supervisory, warning and decision notices. The Regulatory Decisions Committee (RDC) currently makes decisions on contested enforcement and certain supervisory and authorisation matters on behalf of the FSA. The RDC is a non-executive committee of the FSA Board, with a chairman and other members from the financial services industry and other professions. Many other FSA statutory decisions are taken by senior FSA executives, including decisions to settle enforcement cases. In contested cases, a firm or individual has the right to refer a matter to the independent Upper Tribunal.

The FCA will retain the FSA's current allocation of decision making between the RDC and senior executive. Any decision to change the current procedures will be a matter for the future FCA Board following a public consultation.

Financial crime

Stopping firms being used to facilitate financial crime will continue to be a priority. We will focus on the types of firms that are most vulnerable to abuse by criminals (whether because of their size, customer base, product lines or corporate culture).

The work to tackle financial crime influences many of the FSA's activities – such as deciding who is allowed to own and run a financial firm, what questions are asked of firms, and how

or whether to punish those that fall short. We believe an important way of keeping our markets clean is to keep criminals and unscrupulous characters out of the industry. We need people who own and manage the firms we regulate to be people of integrity.

Scrutinising the industry

We will look at how firms prevent abuse by criminals and question whether they are doing enough. Three important financial crime risks are:

- **Fraud:** we will use a range of techniques to see if financial firms have strong enough defences, in particular to help prevent frauds against consumers, such as 'boiler rooms' and Ponzi schemes.
- **Money laundering:** we will look at the steps firms take to detect and prevent money laundering, particularly focusing on high-risk customers and products. We will continue to use thematic reviews and targeted visits to test how the industry is improving practice in this area following recent FSA supervisory work and enforcement action, which found serious deficiencies. We will also devote more resources to ensuring the biggest retail and investment banks are complying with their legal and regulatory obligations through our Systematic Anti-Money Laundering Programme – a cycle of in-depth reviews of anti-money laundering and sanctions systems and controls. We will continue to make examples of firms who take unacceptable risks.
- **Bribery and corruption:** we will take action against firms that are found to be using corrupt methods, or failing to prevent bribes being paid to win business.

Protecting people from scams and swindles

We will take action against firms and individuals who unlawfully conduct activities (such as 'boiler room' frauds, land banking scams, rogue carbon trading firms and fraudulent collective investment schemes). We will alert

the public to the dangers of such schemes and will help return funds to victims where the courts have been able to recover money from fraudsters.

In March 2012, the FSA won a High Court action against three land banks that had run a £32m scam, selling plots of land unlawfully to UK consumers. This followed action taken during 2011 to close down several land banking firms.

Education can be effective and long-lasting when it comes to helping consumers to avoid falling for scams and swindles, and we will continue to help consumers be aware of risks.

In April 2012, the FSA contacted over 76,000 people to let them know they were targets for fraudsters. Their names had appeared on lists recovered from companies that we believed were fraudulently selling investments in land or worthless shares. We also published information sheets and web pages on scams and swindles so the public could recognise and avoid them.

Cooperating with other agencies

We will work closely with other organisations both at home and overseas to combat financial crime, whether through contributing to international standard-setting bodies, sharing intelligence or developing partnerships to coordinate action and bring people to justice, particularly if such crime affects UK consumers or markets.

A criminal share-dealing operation defrauded £27.5m from 1,700 investors over six years. The trio responsible were sentenced to a total of 19 years in prison after a joint investigation by the FSA, the City of London Police and Eurojust, with assistance from over a dozen police forces and regulators. Joint working was essential to secure this result.



CHAPTER 5:

BUILDING OUR UNDERSTANDING
OF THE MARKETS

Our new Policy, Risk and Research Division will act as the radar of our new organisation. It will combine research into what is happening in the market and to consumers with better analysis of the type of risks and where they appear. This will then drive the actions that we take across the organisation.

In summary, this new division will:

- identify and assess risks to consumers, firms and markets – both emerging and current;
- create a common view of the risks in financial markets to inform the FCA's authorisation, supervision and enforcement decisions; and
- use the knowledge of these risks to make evidence-based policy¹⁶ that changes behaviour.

How we will do this

We will gather and use a wide range of data, information and intelligence from across our organisation, firms and elsewhere to help us identify and assess risks in financial markets. This will include economic and market analysis, consumer complaints and enquiries, media analysis, and intelligence from consumer organisations and professional firms.

This means placing much more emphasis on gathering and using intelligence on consumer behaviour, experiences, concerns and risks than previously, with an increased focus on problems with basic products and services. By gathering the right information at the right time, we can identify risks to consumers early on and work on the issues that pose the greatest risk of harm. We can then take quicker action against the poor practices that are causing consumers harm.

Whilst whistleblowing is important, we will also seek out and listen to what firms,

Sources of intelligence

We want to encourage firms and individuals to talk openly about issues they find and trends in the market. If we work together to address problems faster, this will help enhance the industry's reputation and keep regulatory costs down in the longer term.

One of the many ways in which information is currently received about regulated firms, individuals and other market participants is through whistleblowing. People can make allegations to the FSA in a number of ways, including through a dedicated telephone line – 020 7066 9200 – or email – whistle@fsa.gov.uk – as well as face to face. The information received is analysed and investigated before a judgement is made about whether to take further action.

The FCA will continue to collect and act upon the intelligence received from whistleblowers wherever appropriate, and take each individual case seriously.

As this is a judgement-based process, there will inevitably be times where decisions are made that with hindsight, are incorrect. We will place significant value on whistleblowing alerts and seek to provide as much useful feedback to the whistleblower as possible, within the restrictions we are bound by.

consumers and others tell us about poor behaviour in the marketplace. We will use this information to ensure our policies address actual concerns and experiences. We will be continually asking questions, and will be more curious about what is going on in the market, taking incisive action as a result.

¹⁶ The Markets Division will retain responsibility for policy making for primary, secondary and over-the-counter (OTC) derivative markets, wholesale conduct and client assets.

Our risk-based approach

We will use our knowledge of risks to consumers and in financial markets to inform the work that we do.

Like other organisations, we must decide how to apply our resources to do our job in the most effective and efficient way.

The main way we can achieve this is by having a risk-based approach. This means we will make decisions and take action based on the risks to us meeting our objectives. The FCA will not be able to prevent or control everything that causes harm to consumers or financial markets. Besides market failures, there may be other causes of detriment, which public authorities cannot prevent or mitigate. Unforeseen problems, such as those in the global economy can impose large losses on even long-term investors in shares.

Market failures, especially information problems and consumer errors, are widespread in retail financial markets and have been persistent. If we tried to address all the symptoms rather than the root causes of such failures, the cost would be prohibitive and the approach required could stifle innovation and competition. This could in turn lead to greater harm, since competition delivers to consumers the choice of products they really want at the lowest achievable price. This is why the regulatory framework includes the FCA's competition objective and duty, as well as the 'safety nets' of the Financial Ombudsman Service and the Financial Services Compensation Scheme, which enable consumers to get redress when a firm has not treated them fairly, or has gone bust.

We will assess risk in relation to our legal objectives and duties, and prioritise action where we believe there is the greatest risk to achieving those objectives. This assessment has three stages:

1. measuring the risk of or actual market failure;
2. prioritising the risk in relation to other issues; and
3. designing the right regulatory strategy.

For the most significant issues, we will be able to prioritise resources and reallocate them between issues or business areas as necessary.

Decision making and resource allocation

Our risk-based decisions will be tailored to each area of the FCA, and made within a strategic risk framework. To create this framework, we will develop a way of comparing and, where possible, quantifying risks within and across all of the areas we cover. The framework will enable us to agree both the activities that meet our legal responsibilities, and the additional work that allows us to identify and deal with risks to our objectives.

Our responsibilities cover a wide range of firms, from global financial groups to sole traders, and an equally wide range of financial activities, services and products. We will not use the same approach in each situation, and so our decisions will come down to our staff using their judgement. We want to assess risks in a standardised way to ensure these judgements are based on shared principles, and will build a model to facilitate this. This will help ensure we consistently prioritise the most important issues.

When we conduct our annual internal planning our resources will be allocated between different parts of the organisation, for example authorisations and enforcement; and different sectors, for example banking and asset management. This allocation will be based on our planned regulatory activities and risk outlook for the year ahead. If the environment changes significantly, we will reprioritise during the year.

**...we will
make decisions
and take action
based on the risks to
us meeting our
objectives.**

How this will work throughout the FCA

By bringing together our information-gathering, analysis, research and policy making into one place, we aim to make sure that we are in a position to make timely and effective interventions when we identify risks. The types of response we make could combine policy, supervision, authorisations or enforcement action.

For example, when we authorise a firm or an individual, or vary a permission, there are statutory tests that set out what we will have to consider when making a decision. We will not be able to apply a different legal test, but we can decide how much resource to use to decide whether the test is met. To do this, we will consider the risk profile of the firm and a range of factors that dictate the importance of the decision; one of these will probably be the number and type of customers potentially affected by the transaction.

By bringing together our information-gathering, analysis, research and policy making into one place, we aim to make sure that we are in a position to make timely and effective interventions when we identify risks.

Also, as set out in Chapter 3, regular supervision risk assessments will take place across most authorised firms. The frequency and intensity of these are determined by the firm's size and its potential impact on our objectives. There are three separate but related prioritisation processes within supervision: the Firm Systematic Framework; issues and product work; and event-driven work. The first and second of these are forward-looking, while the third is, by its nature, reactive. As necessary, resources will be moved between sectors and between these three types of work.

The link between high-severity incidents and regulatory performance

We are also considering how previous conduct issues can help us evaluate our overall success. This evaluation will help us decide when we need to provide a formal report to the Treasury.¹⁷

It is widely agreed that a problem the size of PPI should not be allowed to recur. Consequently, the FSA Board decided that it would have zero tolerance of absolute loss to retail consumers in excess of £250m and that smaller but still significant total losses should not occur more frequently than once every five years.

It is clear that the Government and Parliament, as well as other stakeholders, believe this figure of £250m is too high for the FCA. Consequently, we aim to prevent problems occurring by being more forward-looking and intervening earlier. We will also want to focus our efforts, where there are choices to be made, on protecting more vulnerable consumers.

An example of what this could mean in practice is in the diagram on page 44. This sets out how the PPI issue developed over a number of years, in terms of the number of customers affected (incidence) and the amount of harm suffered (severity).

We will aim to prevent any issue ending up in the red zone, which represents many customers and high amounts of harm. We will also want issues in the yellow or orange zones to be exceptional (so no more than once every two years in the yellow zone and no more than once every five years in the orange zone).

As a result, most action relating to an issue we identify and consider likely to grow will need to be carried out very early – in the diagram this will be in the green zones, most likely those with a dotted pattern.

¹⁷ See Chapter 7 for more information on when we will have to make these reports.

This will be challenging for us because it means we will need to gather data and identify risks that are quite small – in terms of incidence and severity – such as where 10,000 customers have lost £300 each. It will mean an increased focus across the FCA – through our Authorisation, Supervision, Policy and Enforcement teams.

In practice, we will be more concerned about consumers – especially more vulnerable consumers – who might lose money or become further indebted, than about firms being able to continue in business (where the FSCS provides a safety net), except where the integrity of markets is threatened, or the firm represents a prudential risk. This will require us to develop a new, more sophisticated approach to monitoring emerging risks that could harm consumers, and capturing issues that affect consumers of basic products, as well as those buying more sophisticated products and services.

Research

We will conduct rigorous research into the risks in financial markets for both firms and consumers. We want to draw upon a wide pool of knowledge, research resources and opportunities to strengthen our knowledge and understanding of all segments of the market.

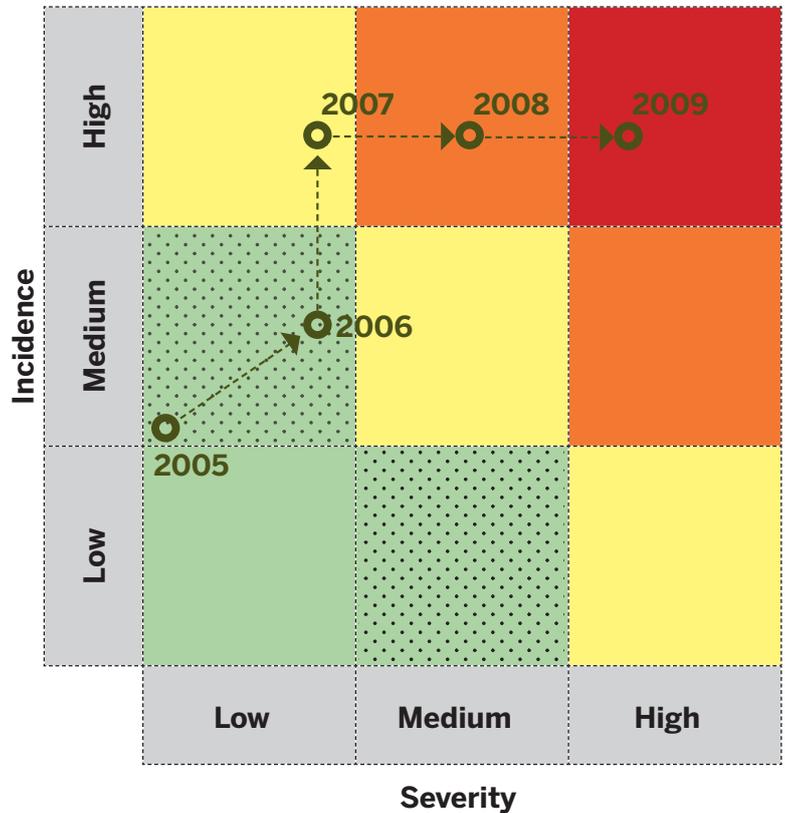
We will commission new areas of work from external experts and use a wide range of established and newer techniques, including behavioural insights to increase our ability to understand and respond to emerging issues and concerns. We will ensure research insights inform our policies so that they are based on a full understanding of market issues, including competition, consumer experiences, behaviour and market failures (see box on page 45 for more information).

Policy making

As an organisation we aim to set out a clear vision of what successful markets look like, then monitor markets and identify

Our policies will set out our expectations of firms, focusing in particular on changing behaviour in financial markets.

PPI development over time



risks more effectively by improving our intelligence and research, and our understanding of why markets fail. Doing this will allow us to identify and prioritise the right interventions and remedies to fix the harm caused and control the risks – including making changes to our policy.

Our policies will set out our expectations of firms, focusing in particular on changing behaviour in financial markets. Our Board will agree our policies, and we will continue to consult on our rules and guidance before they are published in our Handbook.

The Handbook

We will publish our core standards in a central handbook (or rulebook). Most provisions within the FSA's Handbook will be incorporated into two new handbooks, one for the FCA and one for the PRA.

Using behavioural insights to deliver better outcomes for consumers

Insights and techniques from the behavioural sciences and behavioural economics have great potential to explain why people make predictable mistakes when choosing and using financial products and services. All consumers are prone to make mistakes because of their inherent biases, and because financial decisions are complex: it is hard to make trade-offs between the present and the future when saving or borrowing, to assess risk and uncertainty when buying insurance or investing, or compare complicated products across the market.

Firms often react to these mistakes, and consumers can be harmed even if that is not the intention. The presence of biases can affect the nature of competition in markets, leading firms to compete in ways that are not in consumers' best interests or to set prices with little regard to the prices of their competitors (known as 'market power').

Behavioural biases can also interact with other problems in markets, such as barriers to entry or information asymmetries.

We will use behavioural economics to better understand consumer behaviour and how firms exploit behavioural biases. We will apply behavioural theories when identifying potential problems, diagnosing their root causes, and designing and testing remedies. When needed, we will target interventions to stop exploitative practices. Behavioural economics will also help us determine what level of protection consumers need and where we should set the limits of consumer responsibility. We will address other issues, such as clarifying when seemingly mistaken choices may reflect the genuine desires of consumers.

The FSA intends to publish a paper before Day One on the existing evidence on consumer behaviour in retail financial markets. Following the launch of the FCA we will also publish original research that tests and evaluates behaviourally informed regulatory interventions with the aim of finding out what works best for consumers.

At Day One, firms will be able to access online:

- the FCA Handbook, displaying conduct provisions that apply to all regulated firms and the prudential provisions that apply to firms prudentially regulated by the FCA;
- the PRA Handbook, displaying provisions that apply to firms prudentially regulated by the PRA; and
- a combined version, displaying the provisions of both Handbooks, with clear 'badges' indicating which regulator applies each provision to firms.

We plan to make the new Handbooks available before Day One to help firms prepare for the transition to the new regulators.

Over time, the way our principles, rules and guidance are presented and organised in our FCA Handbook, and in non-Handbook material, will inevitably change. As it does,

we will take the opportunity to change the way we present material to make it more user friendly and accessible. We will take account of the views of our stakeholders before introducing changes to achieve this. In addition, we and the PRA will be required to cooperate, coordinate and consult with each other over relevant changes to our rules and requirements.

Once established, we will review the way we present our Handbook and other guidance materials. For example, we are already reviewing the way that non-Handbook guidance – letters to firms, issues and product reviews, case studies, etc – can be used as an effective tool for firms. We want to issue more concise and clearer guidance than previously.

Engaging earlier

We will talk to the people our policies affect and listen to their ideas right from the outset so as to include their views in the development of policies where appropriate.

We intend to make consultation easier and not a burden. We will develop engagement opportunities across the country, whether face to face, online or via third parties. This applies to everyone, from market representatives, firms and other stakeholder groups, to retail consumers. We will also use a new consumer segmentation model to validate the audience choices we make.

We will be clear about the scope and impact of our proposals and to what extent we are required to implement them as a result of European legislation, and will consider the burden of the consultations we issue. We will produce fewer, more focused consultations than we have done in the past, and discuss proposals face to face where appropriate.

Our Markets Division

We continue to be the UK's securities markets regulator, overseeing billions of pounds of equity and debt funding raised by companies every year through the UK's primary markets and the subsequent trading of securities on those markets, both on-exchange and bilaterally negotiated. We will also inherit responsibilities for overseeing other exchange-traded markets and the £600 trillion over-the-counter derivatives markets. This includes additional supervisory responsibilities following full implementation in early 2013 of the G20 commitments to tackle risks in those markets.

Our Markets Division will tackle these responsibilities in an integrated way across its risk analysis, policy making, supervisory and enquiries functions, and will work closely with all other FCA divisions, particularly on wholesale conduct issues. We will continue to supervise key market infrastructures (regulated markets and multi-lateral trading facilities), but the supervision of clearing and settlement infrastructure will move to the Bank of England.

We will also carry forward our enforcement-focused approach to tackling abusive market behaviour, and failures to disclose information to the markets.

Case study: better policy making

Firms often tell us we produce too much written material and this does not always lead to effective communication and engagement.

So recently, instead of producing a Discussion Paper asking for written feedback from firms about ideas to improve client money policy for insurance brokers, the FSA team talked through the plans with them face to face and gathered firms' immediate feedback.

At seminars organised by the British Insurance Brokers Association between February and May this year, firms were taken through the ideas and the FSA team listened to their views. We collected more information and gained more immediate feedback about the impact of what was being suggested than the traditional route would have achieved.

The proposals published by the FSA in September were able to take account of the insights of the end-users. An immediate change is the language in the document, which will be more easily understood by the brokers who need to read it. This will remove the need to produce a separate guide explaining the final rules, which the FSA did last time these rules were updated. It will also mean that when we publish our final rules as the FCA, they are more likely to be easily understood and therefore better applied by those they affect.

However, we will have the opportunity to do some things differently, due to the new operational objectives for the FCA, new supervisory and disciplinary powers in relation to recognised investment exchanges, sponsors and primary information providers, and changes in the regulatory structure in the UK and the EU.

The impact of regulatory action on market abuse

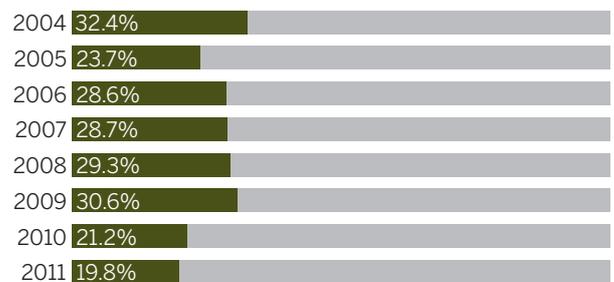
Measuring how often insider trading and other forms of market abuse take place, and understanding how the action we take affects the level of abuse, will help us assess and improve our performance.

The Market Cleanliness Statistic was developed to gauge insider trading before important corporate announcements. In 2010 and 2011 there was a marked fall in abnormal pre-announcement price movements from around 30% over the six previous years to around 20% (meaning that 20% of takeovers had abnormal pre-announcement price movements – the figure is expected to be around 10% if no insider trading takes place). This drop coincides with the FSA's greater emphasis on pursuing market abuse enforcement action, as well as a change in the supervisory approach and more education work with firms.

We will build on this with our unique financial transaction database, known as ZEN. We will use ZEN to develop a range of rigorous and reliable statistics that reflect the level of

suspicious trading activity in all of the UK's diverse and complex financial markets. This will underline our aim to clamp down on market abuse and support our enforcement strategy. It will also allow us to measure our performance and continuously improve our market abuse systems.

Abnormal pre-announcement price movements since 2004

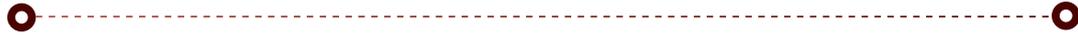


Our regulatory approach to investment markets

Our approach in this broad area of regulation will be characterised by:

- Seeking to influence EU and global policy development (for example, in the European Securities and Markets Authority, in the International Organisation of Securities Commissions and the Financial Stability Board).
- Adopting higher standards than minimum EU requirements where appropriate, for example, in relation to maintaining the quality of the UK primary markets.
- Delivering robust and tailored specialist supervision in a number of areas¹⁸ by taking advantage of new supervisory and disciplinary powers available to us.
- Using policy expertise and supervisory assistance for our re-invigorated and more systematic focus on wholesale conduct issues.
- Supporting the pursuit of the credible deterrence enforcement strategy alongside educational work in all areas of Markets Division's regulatory responsibilities.
- Enhancing our use of regulatory data, such as transaction reports, for surveillance and risk identification.
- Collaborating internally and with other regulators to identify and mitigate risks.

¹⁸ Specialist supervision areas: client money and assets; market infrastructures; regulated covered bonds; sponsors, suspicious transaction reporting regime; transaction reporting regime.



CHAPTER 6:

MAINTAINING EFFECTIVE RELATIONSHIPS

Maintaining effective relationships with stakeholders will be vital in order to achieve the FCA vision. There will be a very wide range of stakeholders, such as the PRA and the Bank of England; the regulatory family including the Financial Ombudsman Service (the ombudsman); other EU and international bodies; financial services firms; consumer organisations; and audit and law firms. In this chapter we set out how we will work with some of these organisations.

We will maintain statutory *memorandums of understanding* with some of these organisations; setting out how we will work together. These agreements will be important, but what will actually make the system effective is a culture of working together, which our senior management will encourage.

The regulatory family

We will be part of the wider family of regulatory bodies that are in place to protect financial consumers:

- The ombudsman provides an independent, free-of-charge service that helps consumers to handle their complaints against firms.
- The Financial Services Compensation Scheme (FSCS) may pay compensation to consumers when a firm is unable, or likely to be unable, to pay claims against it, usually because it has failed or ceased to trade.
- The Money Advice Service provides free, unbiased advice to help consumers make the most of their money.

Each organisation plays a vital role in protecting consumers and helping to achieve better consumer outcomes.

We will have statutory oversight of the ombudsman, the FSCS (jointly with the PRA) and the Money Advice Service, although

“ Maintaining effective relationships with stakeholders will be vital in order to achieve the FCA vision. **”**

they will be operationally independent. This means we will be responsible for ensuring they are capable of exercising their functions, and we will have powers relating to board appointments. We will maintain strong, open and flexible relationships with each organisation, as they can provide us with very useful insight into the issues affecting consumers and how firms are behaving – such as the types of problems that consumers contact the Money Advice Service about. We will then be able to use this information to decide whether to intervene and to inform our policies and other activities.

Working with the ombudsman

The Financial Services Bill sets out two new ways for the ombudsman to bring issues to our attention.

We will maintain strong, open and flexible relationships with each organisation, as they can provide us with very useful insight into the issues affecting consumers and how firms are behaving...

The ombudsman will have to provide us with information about the level and nature of the complaints it receives when it thinks this information would or might help us achieve our objectives. This will give us an early view of the issues affecting consumers, which will mean we can be more proactive in our actions.

It will also be able to refer matters to us if one or more firms are regularly failing to meet our requirements and consumers have suffered, or are likely to suffer, as a result. We will publish a response to this referral within 90 days, setting out how we have dealt with the referral and whether we have decided to take any action.

Working with EU and other international bodies

We fully recognise that an increasing part of our work will be to implement, supervise and enforce EU and international standards. The FCA will actively bring its expertise to international debates and rule-making, to ensure that the standards set on consumer protection and market integrity are consistent with our objectives. In particular, we will provide thought leadership and influence to achieve outcomes that work for UK consumers and firms.

Our negotiating positions will be based on a comprehensive understanding of what is in consumers' interest and on ensuring there is no dilution of consumer protection at domestic level. In addition to defending our positions, we will seek opportunities to shape debates and lead work at the very earliest stages.

We may take action to address domestic issues even if standards are due to be set internationally at a later date. An example of this is the Retail Distribution Review (RDR), which has led to the UK setting its own conduct rules in the retail investment market despite European standards being developed subsequently.

We recognise this has implications for firms and that they may feel they have to implement similar sets of standards twice. In these situations, we will look to strike a balance and carefully analyse the most appropriate action as to whether to hold back domestically or press ahead with our own solutions.

We will maintain constructive relationships with our key EU and international stakeholders and engage early with new policy initiatives and debates as they emerge. We will recommend circumstances where we think EU-level action is appropriate.

Similar or related issues are often discussed at a range of different EU and international meetings. Representation at these meetings will be split across the Treasury, the Bank of England, the PRA and the FCA.

While the Treasury will continue to lead on UK negotiations on EU directives and regulations, we will be responsible, with the PRA, for developing draft technical standards through the European Supervisory Authorities.

In particular, we will play an active role in leading and developing the EU and international policy agenda through the European Securities and Markets Authority and the International Organisation of Securities Commissions. We will also be represented on the Joint Forum, which deals with issues common to the banking, securities and insurance sectors, and play a role in the Financial Stability Board. We second a number of our experts to advise EU and international bodies.

We will coordinate and consult with the Treasury, Bank of England and PRA on issues of common interest or concern. The ways in which this will work in practice have been set out in a *Memorandum of Understanding* that outlines the principles that our international engagement will be based on. We will also be a member of a new International Coordination Committee, which is responsible for ensuring the UK authorities act in accordance with these principles.

We will maintain constructive relationships with our key EU and international stakeholders and engage early with new policy initiatives and debates as they emerge.

Throughout all of our negotiations and discussions we will aim to ensure that our representation is effective, coordinated and balanced, and that consumer protection and conduct issues are considered.

We will work closely with other organisations, both at home and overseas, to combat financial crime, whether through contributing to international standard-setting bodies, sharing intelligence, or developing partnerships to coordinate action and bring people to justice, particularly if those crimes affect UK consumers or markets.

Simple steps, such as having one main point of contact for consumer representatives to talk to, will ensure that colleagues in these organisations know their issues are dealt with properly.

We will continue with this forum and it will help us listen to current and emerging concerns for consumers; it will act as a sounding board for policy development, issues and products work or emerging issues. We will retain the Consumer Panel, which will assist with these issues but also continue to provide scrutiny and ensure accountability.

Working with consumer organisations

We will look at our regulation from a consumer's point of view to ensure that it focuses on the people we are here to protect. To do this most effectively, we will work with consumer groups so we can better understand issues and emerging problems that people face – especially those related to straightforward products that most people use, like bank accounts or general insurance. We aim to make it as easy as possible for consumer groups to work with us so we can mutually benefit from their information, knowledge and experience to improve the way we regulate.

Consumer groups do not always have the resources to develop the evidence that supports early intervention to prevent consumer harm, but we will encourage them to tell us about issues they spot as early as possible. Information from all sources will form the basis of our wider intelligence gathering, and we will use this to build a fuller picture of an issue.

We do not intend to inundate or overwhelm these organisations; we will carefully assess our requests to consumer groups for help and information. We will be flexible about the needs of the organisations and, where possible, we will do more things face to face or via online forums rather than always through written consultations.

“ We will look at our regulation from a consumer's point of view to ensure that it focuses on the people we are here to protect. ”

We are conscious of the lack of resources that some organisations have. We want to make the most of our relationships, engendering trust and encouraging a productive, open conversation. Simple steps, such as having one main point of contact for consumer representatives, will ensure that colleagues in these organisations know their issues are being dealt with properly. The FSA has already established a group called the Consumer Network, which includes organisations such as the Money Advice Trust and Citizens Advice, and will meet twice a year.

Understanding consumer behaviour is important to our overall philosophy, as set out in the behavioural insights section in *Chapter 5*, and the way we engage with consumers. We will develop a detailed retail consumer segmentation model that allows us to understand both people's attitudes towards financial services and what drives their behaviour. We will publish our findings in 2013. This work will link to our developing thinking on how we can utilise behavioural economics, and how this in turn influences our policy making and supervisory approach.

The way we engage with consumers will change as a result of both our strategic and operational objectives. We want to go beyond just making consumers aware of the FCA, so they feel reassured that we are there to protect them.

We will engage directly with them, to let them know about scams, to counter misinformation, to make a complex matter more accessible, or to improve their ability to understand the market.

We will seek to use the most appropriate channels to reach the audience, whether that is our own direct material or using our relationships with consumer organisations, other stakeholders, and sometimes the firms themselves. Our interest is in making sure consumers get the information they need, in a way they can most easily benefit from and via the most credible channel. We recognise that information alone is often not enough, which is why our understanding of behavioural factors and the segmentation analysis are fundamental to developing the right approach to communicating with consumers.

We will make it easier for people to engage with us on matters that concern them. Our website will be clear, simple and straightforward to use. We will make it easy for people to comment on our consultation papers, connect with other regulatory bodies, know their rights or get in touch to help us understand poor practice or their experience.

Working with firms

We recognise that we have to communicate more effectively with firms that want to do the right thing, and we must be clearer about our expectations.

Beyond Day One, as many firms will no longer have their nominated supervisor, we intend that our Contact Centre will be able to handle more issues at the first point of contact for many firms, without needing to refer them on to our supervisors. And we also aim to improve our online support for firms.

We have started a programme to develop the Contact Centre's skills and knowledge so that the staff are equipped to deal with a broader range of issues. We will have more people on hand, including sector specialists who can answer detailed questions when firms call.

“ To support all firms, we will provide more regional workshops and roadshows to clarify our expectations on the risks and issues that we believe are important...”

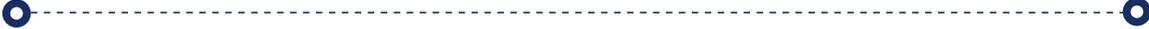
As part of the Revised Approach to Small Firms Supervision explained in Chapter 3, we will have a programme that includes us proactively contacting newly authorised firms to explain their regulatory obligations and reporting requirements.

To support all firms, we will provide more regional workshops and roadshows to clarify our expectations on the risks and issues that we believe are important and to cover the subjects firms tell us they want help on. We have successfully piloted these events, with our Positive Compliance Workshops, which were about attitude to risk, writing high-risk business, and the advice process.

As part of a more open approach, we intend to engage more with firms, trade associations, the practitioner panels and other relevant stakeholders when we start pieces of thematic work on issues and products. We will aim to communicate what the problems are that we are investigating and how we intend to carry out the work. With the industry's cooperation and input we believe we will deliver better-quality supervision and clearer good- or poor-practice examples to report back on.

Our senior supervisors have already begun networking with firms in their sector to gather better intelligence, improve our communication with them and ensure they understand our expectations. For example, our head of asset management meets with firms regularly, including those in the sector who advise investors, to find out what is happening in the market and to get our messages across.

The FCA website is currently being developed as a resource for all users, with clear signposting to help users find what they need quickly. There will be a dedicated firms section from Day One.



CHAPTER 7:

ACCOUNTABILITY,
TRANSPARENCY AND
MEASURING OUR SUCCESS

Accountability

Our Board

Our Board will be made up of executive and non-executive members. John Griffith-Jones has been appointed as chairman. The Board's role will be to challenge our executive, to hold them to account and to set our overall direction. It will ensure that we achieve value for money, remain cost-effective and oversee future senior executive appointments.

Panels

We are required to consult practitioners and consumers on the extent to which our practices and policies are consistent with our general duties. One of the ways we will fulfil this requirement is through our relationship with four independent panels that will represent the interests of their constituencies to us:



We will consider the representations made to us by the panels and, from time to time, publish our responses.

Complaints, freedom of information, and audits

We will have a formal process for dealing with complaints about the FCA. This will be part of a single complaints scheme between the FCA, PRA and Bank of England, and will continue to be subject to the Freedom of Information Act.

There will be a new requirement for the National Audit Office to be our statutory

auditor, with the power to carry out value-for-money reviews. The Treasury will also be able to carry out economy, efficiency and effectiveness reviews.

Investigations into regulatory failure

As part of our ongoing accountability, we must carry out an investigation and subsequently report to the Treasury if there has been a significant regulatory failure.

This will be where it appears to us that two conditions have been met:

1. a significant failure to either secure an appropriate degree of protection for consumers; or a failure that had or could have had a significant adverse effect on the integrity of the UK financial system or on effective competition in the interests of consumers; and
2. the events occurred, or were made worse, because of a serious failure on our part.

The Treasury may require us to carry out an investigation and report to them where they consider that the conditions have been met, or if they think that an investigation is in the public interest.

We will issue a statement of policy on investigations. This will cover what we will take into account in deciding whether the above conditions are met.

Transparency

The new ways of working that we have described in this document will take place with an appropriate level of transparency. The firms we regulate have a huge impact on people's daily lives and our economy, so we know that, as a public body, our duty is to do what we do in a way that is as open and accountable as possible.

We will be clear in communicating our thinking and the way we work, and will be open to scrutiny from consumers, firms and Parliament, and more accountable on how we manage our costs.

Two new regulatory principles¹⁹ make transparency a priority in our approach:

- the desirability of publishing information about regulated firms and individuals, or requiring them to do so; and
- the requirement to exercise our functions as transparently as possible.

In the first quarter of next year, the FSA will publish a discussion paper that will review ways to embed transparency in how we do our job. The paper will cover how to make more use of disclosure in the way we regulate. Alongside this, we will look at whether we can make firms provide more useful information and how we can be more open about our internal decision making.

Funding

All our running costs will be paid for by the firms that we regulate, through the fees that we charge. We are not directly funded by the Government or the general public.

We want to clearly show people what the link is between the fees we charge and the work we do as a regulator. We will publish our annual fees rates consultation when we publish the business plan in March 2013, followed by the final 2013/14 fees rates at the end of June 2013.

We will also show how we ensure firms get value for money and how we manage our costs. This will include clearly setting out in our annual report why we have spent the money in the way that we have, and the benefits it has brought.

How we will set our fees

For our first fee year as the FCA (2013/14), we will set our fees by adapting the current methodology, making only the necessary changes to accommodate dual regulation. We will consult on these changes before the end of 2012. This will include our governing principles.

During 2013/14 and before consulting on further changes, we will listen to the views of the industry to explore possible alternatives.

Achieving value for money

Good regulation needs to be properly resourced to be effective and at the same time we are determined to ensure that resources are used efficiently. We will have a comprehensive value-for-money strategy, owned by the FCA Board, with appropriate governance and robust challenge mechanisms.

We will have a comprehensive value-for-money strategy, owned by the FCA Board

We are developing a variety of incentives and mechanisms to demonstrate value for money, including savings targets, delivering with reduced headcount, and further streamlining the way we procure services. The FCA's business plan for 2013/14 will reflect these and build on improvements made by the FSA, including more thorough mapping of performance to statutory objectives and greater standardisation of management information.

Our staff

The FCA remit asks us to make judgements and intervene early. Consequently, our leaders will need to make decisions and reach judgements faster. These could be unpopular and lead to criticism, so senior staff will have to demonstrate strength and backbone to stick to their actions if they believe it is the right thing to do. We also want our leaders to lead by example and show more curiosity about what is going on around them, to ensure they collaborate better with others both within the FCA and externally. This will enable them to focus on anticipating and acting on the next big risks to consumers and market integrity. We are working on a range of ways to bring about this new kind of culture.

¹⁹ The principles are what we must 'have regard to' when we carry out our work. They are set out in section 3B of the Financial Services Bill: <http://services.parliament.uk/bills/2010-11/financialservices/documents.html>.

Of course, we are not starting from scratch and there has been much to build on from the move to internal 'twin peaks' within the FSA.

Recognising that an organisation's culture has to be set at the top, we have further strengthened our recruitment of senior staff to ensure that we have the right leaders on board. We will continue to rigorously test their technical ability, but also now whether they possess the characteristics and behaviour we are looking for.

We want all our staff to display the desired behaviour and will support them to achieve this. Effective internal and external communication will play its part by reinforcing how our behaviour can lead and has led to good external outcomes. This will help us be clear about what type of people we want, which in turn will help focus our recruitment and target the right people for the right roles. As part of this, we expect to shift the balance towards recruiting more experienced people.

“The FCA must attract and retain the right calibre of people if it is to deliver its objectives.”

The FCA must attract and retain the right calibre of people if it is to deliver its objectives. We face many challenges; for example, a significant number of people are leaving the FSA after being here four to five years, as we are often seen as an industry training ground. We are working on how to attract and keep the best staff as part of a wide-ranging review of the current policies, processes and activities related to our people and our culture. This includes a fresh look at how we recruit and measure our staff performance, as well as the training and development support we offer. These are complex problems for any organisation, which take time to work through, and we aim

to establish clarity and get some key matters underway during the first 18 months of the FCA's life.

One of the sources of good people who understand firms and how they work is of course the industry itself. In the first half of 2012/13 the FSA recruited more than 100 staff from the financial services industry. The FCA will also want to seek people from other industries and from diverse backgrounds, who can apply relevant experience and display the behaviour we are looking for.

Once we have recruited the right people, we need to retain them, and one of the ways of doing this is by providing the right training. This has already begun; for example, our supervisors now have specific modules on oversight of products and understanding consumer behaviour as part of their induction and will have others, such as business model analysis, added in the new year. We will continue the FSA's approach to supervisor induction, which is both training and assessment. Everyone is tested and must be deemed competent, otherwise they are not retained.

For potential new entrants and the talented individuals that we already have, we will need to provide more career progression opportunities. This could mean establishing proportionately more senior positions and responsibilities. We are also improving our performance management methods to ensure that the best people progress and are properly recognised.

Measuring success

Regulatory success is hard to judge, especially to those who may only see the things that go wrong, and not the daily interactions between regulator and firms. Essentially, success is often judged by what a regulator prevents from happening, or worsening, while failure is seen as what is missed or dealt with slowly or ineffectively. To help us further improve the ways we measure our performance we have looked at what similar organisations do.

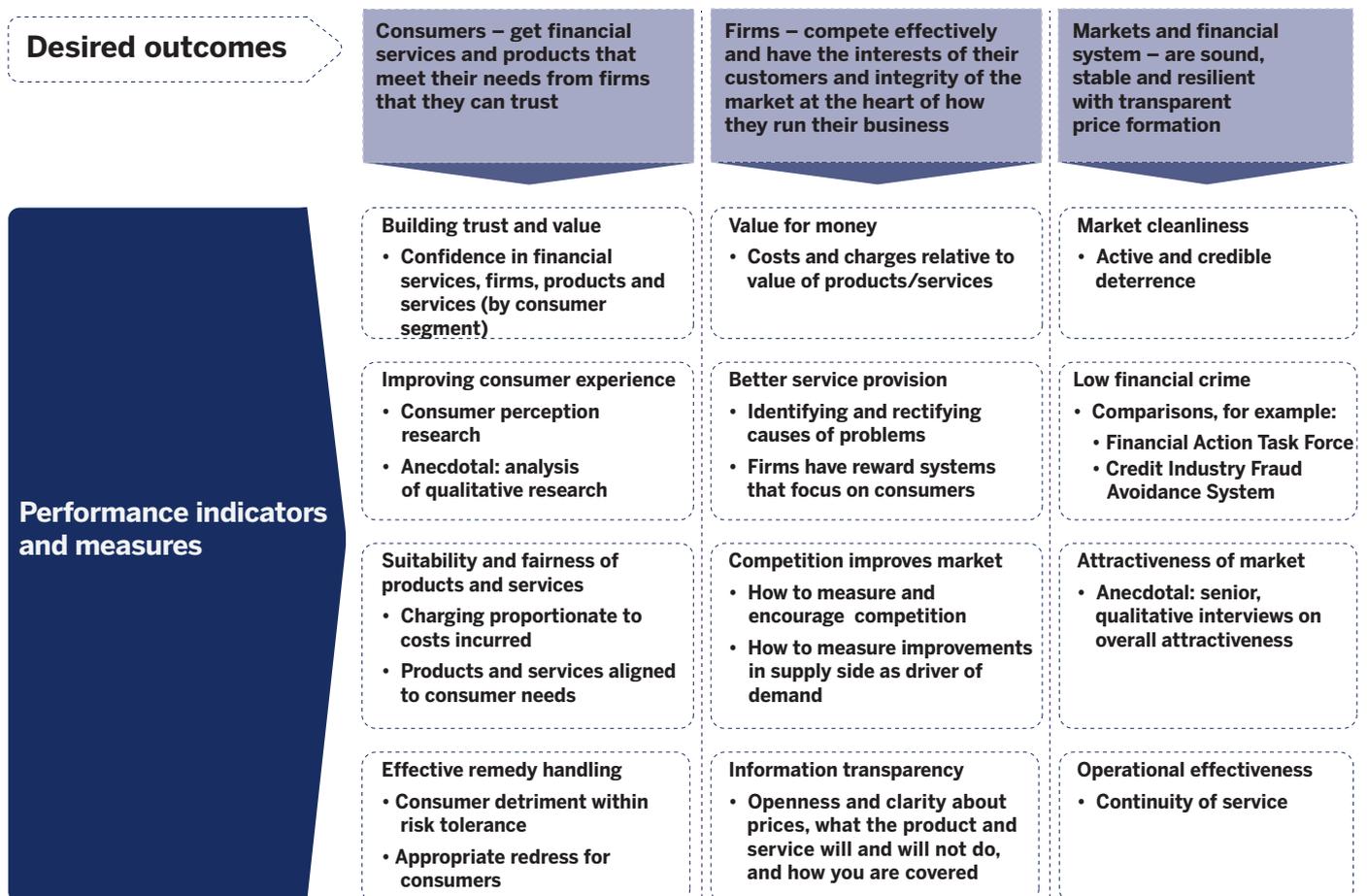
Over the last two months the FSA has consulted representatives from firms and other stakeholders on how they interpret the objectives and what they expect of the regulator. This will help to develop a set of desired outcomes (such as the changes to markets we regulate), which we can measure our performance against.

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only to a degree. For example, a consumer's confidence in financial services can be used to measure our success under the consumer protection objective, but this confidence will be affected by the economy as well as their direct experience of firms we regulate.

We know at this stage that we will be able to influence some of the outcomes example of a possible performance framework for the FCA.

Measuring our performance



Our focus will be on getting better outcomes for consumers, whether this means getting compensation quicker, or identifying problems earlier before they can cause significant harm.

We are also considering eight key success measures that represent some of the things the FCA should achieve in the first two to three years of its existence. These measures are how we have:

- successfully intervened earlier to the benefit of consumers;
- dealt quickly and efficiently with 'crystallised risks';
- actively involved and engaged with our stakeholders and put consumers at the heart of what we do;
- addressed competition issues to the benefit of consumers;
- successfully influenced international policy;
- been able to deliver judgement-based, early intervention regulation;
- delivered business as usual; and
- encouraged positive cultural change in financial services firms.

We still have more to do to develop these measures, and they will be set out in the FCA's first business plan.

As well as our performance against our statutory objectives, we are looking at how we can improve the way in which we measure the impact of our activities.

To learn more from what we do, we will evaluate the impact of our major policy initiatives. This will build on our research commitment and add to it, helping us to understand the true effects of our interventions and address better, over time, the causes of market problems.

Together, all of this will:

- make us more accountable to our stakeholders;
- measure our performance as an organisation;
- evidence how successful our actions are;
- provide our management team with the information it needs to make decisions; and
- provide our Board with the information it needs for effective oversight.

The FCA as time goes on

In addition to making all the necessary arrangements for the transition from the FSA, we are also considering what we will look like in two to five years' time. Our focus will be on getting better outcomes for consumers, whether this means getting compensation quicker, or identifying problems earlier before they can cause significant harm. This will take time as we will have past problems, such as PPI and interest rate hedging products, to deal with. At the same time we will continue to develop our model for delivering forward-looking, judgement-based supervision. Our first business plan will set out our plans for the year ahead in more detail.

While we are planning ahead where we can, there will be issues that emerge between now and Day One that we do not know about today. We need to be prepared for this, as well as constantly monitoring the markets we regulate so that the FSA can deliver its current responsibilities.

ANNEX A: SPECIFIC QUESTIONS FOR CONSULTATION

We are interested in your views on all the content contained in this document. In particular, we would like your feedback on the following items:

Competition

We have told you how we intend to fulfil our new competition objective, but we are interested to hear what you think. We want to know your views on our approach and whether you think something else may work better.

In which financial services markets do you think competition is working well in the interests of consumers and in which ones is it working poorly? What do you think the reasons are for this?

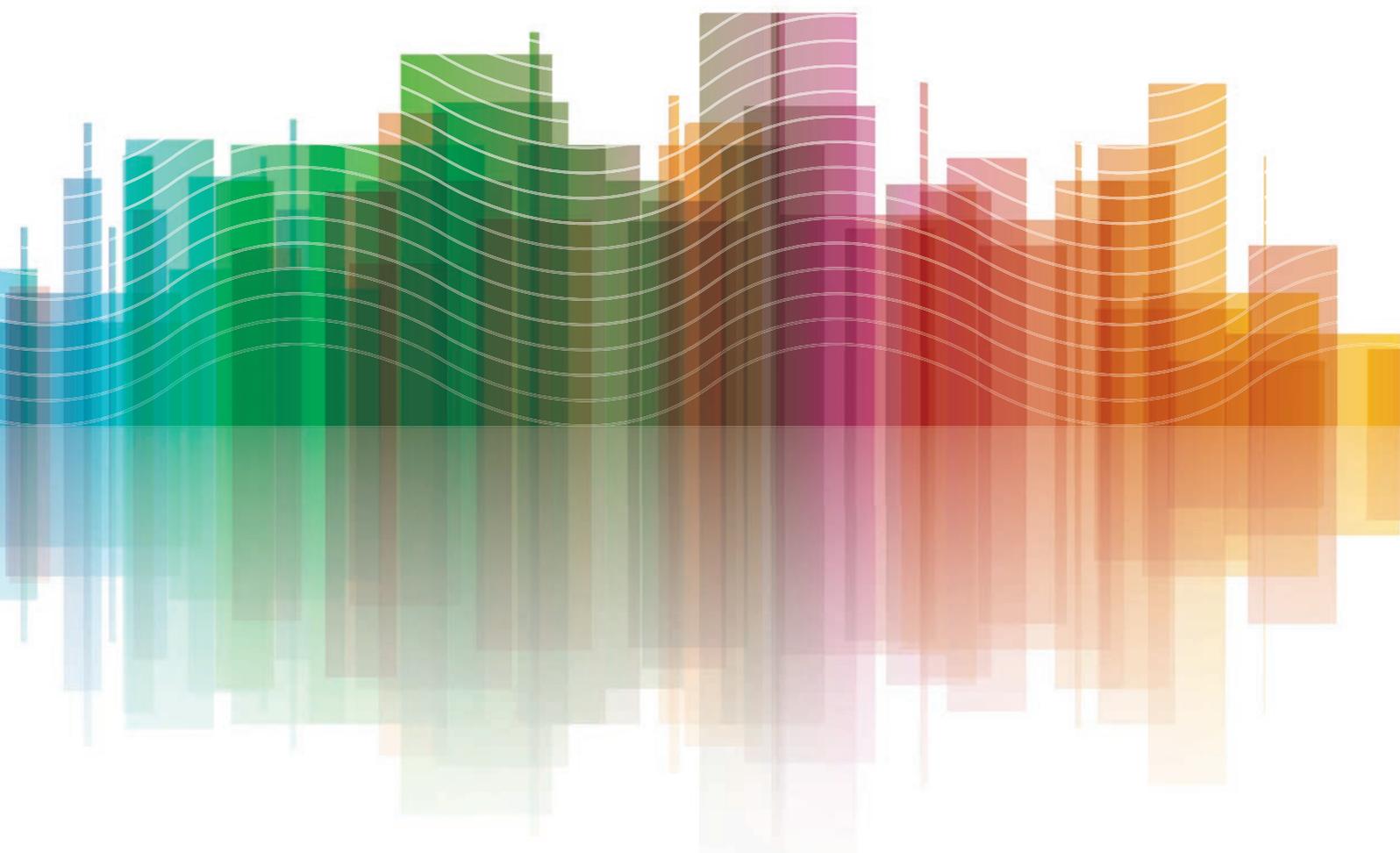
Are there markets in which you face material barriers to entry or expansion? What are the barriers? Are there any undue regulatory barriers?

Gathering and receiving information

We want to gather and receive information about what is going on in firms and the market from as wide a range of sources as possible. We want to hear your views on how this information can be best collected and provided.

How can the FCA make it easier for firms, consumers and organisations to provide information on what is going on the financial services and markets?

What can the FCA do to make you more likely to provide such information to us?



The Financial Services Authority
25 The North Colonnade Canary Wharf London E14 5HS

Telephone: +44 (0)20 7066 1000

Email: fcaapproach@fsa.gov.uk

Website: www.fsa.gov.uk

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